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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1960

No. 413

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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IN THE

Supreme Court of the United States

OCTOBER TERM 1960

No. --------

LYNNE ANDERSON WARREN and PEOPLES FIRST NATIONAL BANK and TRUST COMPANY (now PITTSBURGH NATIONAL BANK), Executors of Estate of JAMES M. SMITH, JR., Deceased,

Petitioners,

against

ALICE S. HIGGINS, on behalf of herself and other stockholders of SHENANGO POTTERY COMPANY (now SHENANGO CHINA, INC.), similarly situated, HILDA BARKBY, Administratrix of Estate of HARRY BARKBY, Deceased, and SHENANGO CHINA, INC.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit entered[1] in the above case on May 10, 1960.

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[1] The certified record contains a Joint Appendix and a separate Consolidated Appendix whose page references are followed by "a" and "aa", respectively.

Opinions Below

The Adjudication of the District Court for the Western District of Pennsylvania dated April 26, 1956 and its Memorandum Granting New Trial dated Oct. 3, 1956 (neither reported) are at 261a-335a; the Opinion of the Court of Appeals dated June 24, 1958 (interim appeal) is reported at 256 F. 2d 504, and is also at 336a-347a; the Opinion of the District Court dated July 27, 1959 (not reported) is Appendix C. The Opinion of the Court of Appeals and its Judgment, both dated May 10, 1960, which are sought to be reviewed, are reported at 279 F. 2d 46, and are Appendix A and B.

Jurisdiction

The Judgment of the Court of Appeals was entered May 10, 1960. Timely petitions for rehearing were denied July 20, 1960.

The jurisdiction of this Court is invoked under 28 U. S. C. A. Sec. 1254(1).

Questions Presented

1. (a) Where a U. S. war contract is presented to a corporation and is unanimously declined by its board of directors in good faith and for valid business reasons, can an officer-director of the corporation openly, without fraud or deceit, and with unanimous approval of all the directors, then become interested in a partnership with outsiders which takes part of the contract and makes a fair arrangement with the corporation to perform the other part, all to the benefit of the corporation, the partnership, and the U. S. Government?

(b) May a Court of Appeals set aside the findings of fact of a Trial Court sitting without a jury, where the findings are not clearly erroneous?

2. (a) In an action for an alleged diversion of a corporate opportunity to an outside organization where there is no fraud, deceit or concealment, should fair compensation for the valuable services of defendants in managing the affairs of the outside organization be deducted before computing the profit of the outside organization?

(b) May a corporation retain benefits of a contract but repudiate the contract?

3. Does laches or the 6-year Statute of Limitations apply when a shareholder waits nearly 6 years before instituting a derivative action against officer-directors concerning a well-publicized corporate war contract?

4. Is an appeal in a shareholders' derivative action properly maintained where appellant-plaintiff fails to disclose to the Court of Appeals that she disposed of the bulk of her stock after the appeal was noticed, but prior to argument and decision?

Rule Involved

Rule 52(a) of the Rules of Civil Procedure (28 U. S. C. A.):

"Rule 52. Findings by the Court

(a) **Effect.** In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon and direct the entry of the appropriate judgment; and in granting or refusing interlocutory injunctions the court shall similarly set forth the findings of fact and conclusions of law which constitute the grounds of its action. Requests for findings are not necessary for purposes of review. Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. The findings of a master, to the extent that the court adopts them, shall be considered as the findings of the court. If an opinion or memo-

randum of decision is filed, it will be sufficient if the findings of fact and conclusions of law appear therein. Findings of fact and conclusions of law are unnecessary on decisions of motions under Rules 12 or 56 or any other motion except as provided in Rule 41(b)."

Statement of the Case

In this shareholder's derivative action on behalf of Shenango Pottery Company, a Pennsylvania corporation located at New Castle, Pa. (Shenango), jurisdiction is based upon diversity of citizenship.

Petitioners are executors of the Estate of James M. Smith, Jr., deceased, a defendant who was President and a director of Shenango.

The facts, generally, are not in dispute: briefly, in January 1944, Shenango, a Smith family-owned manufacturer of china dinnerware, was invited to bid on a contract with the U. S. Army for the manufacture of land mines involving china and non-china techniques. After investigation, and for valid business reasons, Shenango declined. Defendant Treloar, a New Castle business man, revived the project and, with others, formed Castle Engineering Company (Castle) which took the non-china part of the contract, with Shenango, at Treloar's persuasion, taking the china part. Participation in Castle was offered to all Shenango directors and their families (who owned over 82% of Shenango's stock) including plaintiff, who was Smith Jr.'s sister, and whose husband was an officer and director of Shenango, but only Smith Jr. and two vice presidents, defendants Zahniser and Read (who was never served), became partners of Castle. The joint project was successfully completed during 1944—Shenango making a profit of over $248,000 and Castle, over $171,000. Plaintiff, as a shareholder, sued in January 1950, alleging a diversion of the contract. The other four defendants, including Treloar, were partners of Castle, but had no connection with Shenango. Barkby, holder of 2 shares of Shenango stock, intervened in mid-1950.

The case was actively before the same experienced Trial Court from Dec. 1953 to July 29, 1959. Its April 26, 1956 53-page Adjudication, with 167 specific findings of fact and 17 conclusions of law, as supplemented by its 10-page Opinion of July 27, 1959, states the facts in careful detail. Plaintiffs' evidence largely consisted of over 325 exhibits; defendants' evidence consisted largely of oral testimony.

The Adjudication dismissed all defendants except Smith Jr. and Zahniser, and although finding them free from fraud, deceit or concealment, and finding that the Shenango board of directors had originally declined the contract in good faith, held them liable to Shenango and entered judgment against them for Castle's profit before renegotiation, plus 6% interest from 1944. The theory of liability was that Smith Jr. and Zahniser were barred from participating in Castle "simply because it had been presented to Shenango" (412a) and for this technical rule, the Court relied on the 1955 case of *Greene* v. *Allen*, 33 Del. Ch. 508, 114 A. 2d 916. When it was brought out that this case had been *reversed* sub nom *Johnston* v. *Greene*, 121 A. 2d 919 (Del. 1956) just prior to the Adjudication, the Trial Court vacated the judgment and granted a new trial on the question of damages, although maintaining liability.

Meanwhile, an unusual departure from ordinary judicial procedure was taking place which has confused and complicated this case ever since, and seriously affected its proper disposition: at the close of plaintiffs' evidence in March, 1955, the Trial Court orally dismissed three of the non-Shenango defendants; the formal order of dismissal was not entered until Dec. 22, 1955, and in January 1956, plaintiffs filed an appeal to the Court of Appeals. At plaintiffs' request, action on this appeal was postponed until the Court of Appeals insisted it be heard. When, finally, a decision was handed down on this interim appeal on June 28, 1958 (336a-347a) the Trial Court had already filed its Adjudication, vacated its judgment and granted a new trial.

None of these matters was before the Court of Appeals in the interim appeal and petitioners were not a party to that appeal. The Court of Appeals held that a prima facie case had been made against the 3 defendants dismissed, and reinstated them. However, the Court (with Judges McLaughlin and Kalodner as a majority—Judge McLaughlin writing the opinion) stated (341a):

> "Plaintiff's above detailed evidence clearly points to a conflict between the Shenango officer and director defendants' obligation to their company and their self-interest. That evidence indicates those defendants used most every element of Shenango but the hotelware product itself for their own selfish interest."

After hearing additional evidence by all parties at the new trial, the Trial Court filed its opinion on July 27, 1959, in which it

(1) Discussed Judge McLaughlin's opinion in the interim appeal.

(2) Again dismissed the non-Shenango defendants.

(3) Again held Smith Jr. and Zahniser liable to Shenango on the same technical rule of law (now unsupported), in the reduced amount of Castle's profit of $181,603.71 after renegotiation, plus interest at 3% from 1944, and entered judgment for $262,456.58.

(4) Found that all defendants had acted openly and in good faith; the liability of Smith Jr. and Zahniser was "not based upon fraud and deceit under the evidence in this case"; the relationship between Shenango and Castle was in the nature of a "joint venture or common enterprise"; "the method of doing business was for the common good"; and the Shenango directors and Castle partners "had a bona fide desire to further the war effort." (Appendix C, pp. 26-27)

All parties appealed and the 5 appeals were heard together. On May 10, 1960, the Court of Appeals (Judges McLaughlin and Kalodner again the majority) affirmed except as to the dismissal of the non-Shenango defendants, as to which it reversed and ordered them reinstated. The opinion, again written by Judge McLaughlin, (Appendix A), not only disagreed with the Trial Court's finding of good faith in the original rejection of the contract as "clearly erroneous" but actually requoted Judge McLaughlin's statement from the interim appeal that "defendants used most every element of Shenango but the hotelware product itself for their own selfish interest."! (Appendix A, p. 12)

Petitions for Rehearing were denied without comment on June 20, 1960.

Reasons for Allowing the Writ

I. This case involves an important principle of corporate officer-director conduct in the everyday affairs of substantially all corporations; whether an officer or director may, in the absence of fraud, deceit and concealment, participate in an opportunity which, in good faith, has been declined by the corporation is a vital question which should be settled. A holding that under such circumstances an officer-director is forever barred has no basis in logic and would impose stifling impediments on progress. It is no wonder that such a holding is in conflict with every court that has considered the problem.

II. This case involves an equally important policy of this Court's supervision over a Court of Appeals which has set aside such a basic factual finding by an experienced Trial Court sitting without a jury as the good faith and credibility of witnesses who were seen and heard by the Trial Court. The rationale of Rule 52(a) of the Rules of Civil Procedure is a keystone of our judicial framework; if a Court of Appeals can ignore it with the unsupported

statement that the findings of the Trial Court are "clearly erroneous.", or recite unfounded illustrations to buttress this statement, Rule 52(a) is nullified. Here, the illustrations used by the Court of Appeals are unfounded, mistaken and unwarranted.

III. This case involves other important and generally applicable questions of law relating to proper accounting, laches and other matters which have been decided here, in conflict with other Courts of Appeals' decisions.

I. The Courts, since early times, have consistently held that where an opportunity has been declined by a corporation in good faith, an officer and director of the corporation thereafter may participate in the opportunity. Even in *Greene* v. *Allen*, *supra*, before its reversal, there was present a factor of domination and a failure to prove good faith, neither of which is present here.

In reversing that case (*Johnston* v. *Greene*, *supra*), the Chief Justice of Delaware said that the ultimate question in such a case is:

> ". . . the test of fairness."

Before *Greene* v. *Allen* was reversed, it was severely criticized in 31 *New York University Law Review* (February 1956) at pages 403-404:

> "The interest of a corporation in an offer made to it vanishes, however, after there has been a formal rejection of the offer by the board of directors (citing in a note: DuPont *v.* DuPont, 256 Fed. 129 (3d Cir. 1919); Diedrick *v.* Helm, 217 Minn. 483, 14 N. W. 2d 913 (1944)). Rejection of the offer by the corporation is generally a complete defense in an action against an officer, permitting the director to act with impunity . . ."

It is stated, in *Fletcher's Cyclopedia Corporations* (1947), Vol. 3, Sec. 8621, page 232:

> "Where a corporation declines because of legal barriers, to avail itself of an opportunity, or it is the

> settled policy of the corporation not to engage in a particular line of business, or it has declined the opportunity for business reasons, or the transaction is beyond the powers of the corporation, or the opportunity is not available to the corporation either because a party refuses to deal with it or because the corporation sought, but without success to obtain it, the opportunity is one in which the corporation has no legitimate interest or expectancy and may be embraced by an officer or director as his own."

In its Adjudication, the Trial Court squarely based its decision on *Greene* v. *Allen* (284a); after reversal of that case, when it came to write its opinion of July 27, 1959, it had no authorities but held to its theory of technical liability of Smith, Jr. and Zahniser by stating (Appendix C, p. 24):

> "Whether their liability be founded upon a statute, or a breach of their fiduciary relationship to Shenango, or whether it is based simply on public policy, in any event it is not based upon fraud and deceit under the evidence in this case. For purposes of this discussion, their liability is in the nature of *mala prohibita* only."

This is directly in conflict with *Cowell* v. *McMillin*, 177 Fed. 25 (C. C. A. 9, 1910). There, McMillin was president and director of a lime company which also had a barrel plant. A machine for making staveless barrels was offered to the Board of Directors and rejected. McMillin, individually, purchased the patent and made a contract with the lime company (he not voting) to lease its barrel plant to him and buy barrels from him. The Court said (p. 39):

> ". . . that McMillin acquired the title to the barrel machine in good faith with the knowledge and consent of the board of directors of the corporation, and after the board knew all that McMillin knew of the merits of the machine and had expressly refused to become interested in it; that there was no concealment from the board of directors on McMillin's part; that McMillin made the lease of the property and the contract for supplying barrels in good faith,

and that the contract when entered into was not unreasonable, unfair or illegal.

• • •

". . . Thus the case is brought within the rule recognized by the Supreme Court of the United States, namely, that where the director has acted with that candor and fairness which equity imposes as the guide for dealing between him and the corporation, and the transaction is open and free from blame, the director is not forbidden from making a contract with the corporation, or from entering upon a transaction in which he is personally interested. Twin Lick Oil Co. *v.* Marbury, 91 U. S. 587, 23 L. Ed. 328. See also Marshall on Corporation, Sec. 377; Figge *v.* Bergenthal, 130 Wisc. 594, 109 N. W. 582, 110 N. W. 798; Barr *v.* Pittsburgh Plate Glass Co., 57 Fed. 86, 6 CCA 260."

• • •

"Many of the cases cited by complainant's counsel in their brief upon the law are upon facts showing actual fraud . . . The principles of law therein announced do not apply to the facts in the case under consideration."[2] (p. 43)

The Trial Court's conclusion of liability is in error, as is its affirmance by the Court of Appeals, and is in conflict with the decided cases.

II. A Court of Appeals cannot disregard the fact findings of a District Court sitting without a jury unless the findings are clearly erroneous.

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[2] Also in conflict with: *Barr* v. *Pittsburgh Plate Glass Co.*, 57 Fed. 86, 6 CCA 260 (3d Cir. 1893); *Davis* v. *Pearce*, 30 F. 2d 85 (8th Cir. 1928); *Hirshorn* v. *Mine Safety Appliance Co.*, 203 F. 2d 297 (1953), cert. den. 346 U. S. 866; *Dupont* v. *Dupont*, 258 Fed. 129 (CA 3, 1919); *Sellers & Co.* v. *Clarke-Harrison, Inc.*, 354 Pa. 109; 46 A. 2d 497 (1946); *Black* v. *Parker Mfg. Co.*, 329 Mass. 105, 106 N. E. 2d 544 (1952); *Lincoln Stores, Inc.* v. *Grant*, 308 Mass. 417, 34 N. E. 2d 704 (1941); *Lancaster Loose Leaf Tobacco Co.* v. *Robinson*, 199 Ky. 313, 250 S. W. 997 (1923); see also *Hunt* v. *Aufderheide*, 330 Pa. 362, 199 A. 395 (1938).

It is obvious that the conclusion of the majority of the Court of Appeals in the interim appeal that defendants had selfish motives was too deeply implanted to be changed, even by an experienced Trial Court which, by an unusual turn of events, had the Court of Appeals' Opinion before it, and tried to show the conclusion incorrect!

When the Court of Appeals brushed aside these efforts and went so far as to requote from its opinion in the interim appeal, a situation arose which, so far as we can find, is without parallel. When it characterized Smith, Jr.'s phenomenal industry and candid conduct as "calculated indifference to the corporate common good" (Appendix A, p. 12) and Shenango's profit on the venture, of $248,587.58, as "Leaving behind a portion of the spoils . . ." (Appendix A, p. 5) it is evident that the Court of Appeals and the District Court are poles apart on the simple honesty of the men involved.

Rule 52(a) of the Rules of Civil Procedure provides, *inter alia*:

> "Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of witnesses."

Justice demands that this disagreement be resolved in favor of the Trial Court.

The principles stated by the late Mr. Justice Jackson in *United States* v. *Yellow Cab Co.*, 338 U. S. 338, 70 S. Ct. 177, 94 L. Ed. 150 (1949), are particularly pertinent (p. 339):

> "Specifications of error which are fundamental to [the] case ask us to reweigh the evidence and review findings that are almost entirely concerned with imponderables, such as the intent of parties to certain 1929 business transactions, whether corporate officers were then acting in personal or official capacities, what was the design and purpose and intent of those who carried out 20-year-old transactions, and whether they had legitimate business motives or were intending to restrain trade of their

competitors in car manufacture, such as General Motors, Ford, Chrysler and Packard.

"These were the chief fact issues in a trial of 3 weeks' duration. The Government relied in large part on inferences from its 485 exhibits introduced by 9 witnesses. The defendants relied heavily on oral testimony to contradict those inferences. The record is before us in 1,674 closely printed pages.

". . . To us it appears to represent the considered judgment of an able trial judge, after patient hearing, that the Government's evidence fell short of its allegations—a not uncommon form of litigation casualty, from which the Government is no more immune than others.

". . . Findings as to the design, motive, and intent with which men act depend peculiarly upon the credit given to witnesses by those who see and hear them. . . ."[3]

It is not difficult to show that the illustrations used by Judge McLaughlin are, in themselves, "clearly erroneous". For example:

The fact that, on Feb. 21, 1944, the U. S. officials requested Shenango to take the contract in Shenango's name, is of vital significance. Plaintiff-respondents strove mightily throughout the trial to disprove this point. Defendants were able to produce disinterested witnesses of the calibre of Robert C. Downie, the U. S. Army colonel who, in 1944 was district chief of the entire Pittsburgh Ordnance District (testimony at 167aa-172aa) and Norman R. Schade, Chief of its Legal Branch (23aa-39aa), who completely corroborated Smith Jr., Zahniser and Treloar.

And yet, in the face of this uncontradicted evidence, Judge McLaughlin states (Appendix A, p. 3):

"It was then decided, *allegedly* at the instigation of Pittsburgh Ordnance, that Shenango's name be inserted in place of Castle . . ." (italics ours).

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[3] See *U. S. National Assoc. Real Estate Boards* (1950), 70 S. Ct. 711, 339 U. S. 485, 94 L. Ed. 1007; 111 A. L. R. 742; *Lassiter v. Guy F. Atkinson Co.*, C. A. Wash. 1949, 176 F. 2d 984.

Judge McLaughlin stresses that Smith Jr. "voted" on some matters, but ignores such formal requirements on other Shenango decisions. The Trial Court found (412a) that:

> "The dominating personality on the Board, according to all of the evidence, was not Smith Jr. but his father, James V. Smith, Sr. In no sense of the word could Zahniser and Smith Jr. be characterized as dominant or controlling directors."

The opinion states (Appendix A, p. 8) ". . . Smith Jr. forming a company to pick up the opportunity rejected by Shenango *on his recommendation and vote*;" and at p. 9: "Two of the three officers, Smith Jr. and Zahniser, who made the recommendation to Shenango *and voted on it*, subsequently formed Castle." (italics ours)

The evidence is uncontradicted that the original rejection of the land mine contract by the Shenango Board was an informal one. What the opinion ignores is that when the all-important Shenango Directors' meeting was held on February 21, 1944 to authorize the contract, Smith Jr. not only was not present and *did not vote*, but was in Pittsburgh, 50 miles away. The legal consequences of this are disregarded. Smith made no recommendation. He merely passed on the Government's suggestion to the Board. This nonparticipation could exonerate Smith Jr.

The Court of Appeals could not mean that Smith Jr.'s action on Feb. 21, 1944 is construed as "voting" on a matter in which he was interested. It is well settled that a director must attend the meetings of the board and act in person; he cannot vote by proxy.[4]

The opinion states that at the February 21, 1944 meeting the directors had "knowledge that Smith, Jr., one of

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[4] *Greenberg* v. *Harrison*, 143 A. 2d 216, 218, 143 Conn. 519 (1956); *Fletcher Cyc. Corp.*, Perm. Ed. Sec. 427; *Lippman* v. *Kehoe Stenograph Co.*, 11 Del. Ch. 80, 95 A. 895 (1915); *Dowdle* v. *Central Brick Co.*, 206 Ind. 242, 189 N. E. 145 (1934).

their number and son of the Chairman of the Board, was prime mover of Castle, . . . " (p. 8). Such reasoning is meaningless; if the other directors did *not* know of Smith, Jr.'s participation, such concealment should impose liability. The opinion is silent on the fact that Smith, Senior, dominated the Board and that the Board knew that the U. S. was desperate to get the job done. The Trial Court found (414a):

> "Having heard all of the evidence, however, I am under the strong impression that the Castle partners were not only looking for a profit but also had a bona fide desire to further the war effort. The members of the Shenango Board were also motivated by the same considerations."

The opinion refers to defendants' *argument* (Appendix A, p. 5):

> "Defendants *argue* that Shenango's profit is proof that they had the common good in mind and that there was no improper diversion of corporate opportunities; that the land mine project was in reality a joint venture between Shenango and Castle. *This argument* can be dismissed forthwith." (italics ours)

This is far more than "argument". The Trial Court *found* (413a):

> "The point has been raised and also discussed in Judge McLaughlin's opinion that Castle partnership is liable because the assets of Shenango were in the first instance used as credit in establishing Castle as a going concern. It is true, of course, and the evidence shows, that once the venture commenced all the interested persons active in the management of both Shenango and Castle exercised their energies in all directions in order to make a success of the land mine contracts. Materials were difficult to procure. Shenango had ample credit. It was easy to do business in Shenango's name and that was done. But that method of operation was not a surreptitious one. No secret was made of it. From

the commencement of the operation, it was just as much to the interest of Shenango that it be successful as it was to the interest of Castle. The venture proved a bonanza for Shenango as well as for Castle. The method of operation was done with the full cooperation of all members of Shenango's officers and directors. Judge McLaughlin in his opinion says on this subject:

> 'They could not deal with the funds and property of Shenango nor utilize the information and advantage of their officers for any but the common good.'

I hold that the method of doing business was for the common good and the result achieved proves the statement. * * *' It is apparent therefore, that the parties were in a business relationship in the nature of a joint venture or common enterprise. It should be observed, I think, that the parties were operating in war time. 'Conditions in business were far from normal." (italics ours)

Judge McLaughlin's opinion, in disagreeing with the Trial Court's finding of good faith, relied strongly on certain letters to the War Contracts Price Adjustment Board and a Petition to the Tax Court, all dated long after the contracts were completed. At most, these implied that Castle's partners, or some of them, had been functioning since January 1944, rather than February 1944 (the invitation to bid was dated Jan. 31, 1944 and received by Shenango a day or so later), and were determined by the Trial Court to be what they obviously are—statements made long after the event on a relatively unimportant point in the renegotiation bargaining—not prepared by the defendants but by a Washington lawyer. It is significant that Judge McLaughlin's opinion omits material favorable to defendants in a quotation from a letter dated December 30, 1944 signed by Treloar (Appendix A, p. 10). We reproduce the quotation and italicize the omitted material: (175-176a)

> "In the latter part of 1942 and early 1943 James M. Smith, Jr., Zeno Pfau and D. H. Treloar Jr., were investigating the possible adaptability of china and

porcelain to such war items as bombs, mines, etc. *Mr. Smith had developed an idea for an aerial practice bomb made of cast gypsum cement, and considerable time of these three men were devoted to presenting to procurement agencies the possibilities that such a bomb would have. Materials were plentiful and labor required for such an operation was sufficiently abundant to make the operation attractive. In addition, the critical shortage of metals and the pressing need for ammunition of all types added to the attractiveness of the proposed bomb. However, these efforts proved fruitless and the project was temporarily dropped.* During this formative period no formal organization existed and all expenses resulting from these efforts were paid by the individuals mentioned above."

The inclusion of the omitted material dispels the implication that the land mine project using china (as distinguished from a bomb made of cast gypsum cement) was considered back in 1942 or 1943.

The opinion also does a disservice to the Trial Court (Appendix A, p. 10):

> "The trial court bolstered this claim in its adjudication stating: 'It is clear and proven as an undisputed fact that the letter of January 31, 1944, from the Pittsburgh Ordnance District to Shenango was the first communication or actual notice to Smith Jr. of the land mine program.' However, this was contradicted by the trial court itself in its finding of fact No. 73, that 'At or about this time (late 1943 or January 1944 but prior to January 31, 1944) it was known at Shenango Pottery Company that a land mine using china parts was being made by Onondaga Pottery Company.' "

To classify the foregoing as a contradiction by the Trial Court should, we respectfully submit, be sufficient grounds on which to grant this petition. The Trial Court stated that the letter of January 31, 1944 was the first *official* communication from the Pittsburgh Ordnance District. It was also aware that the fact that Onondaga was engaged in a

land mine program was generally known at Shenango in January 1944 (263a):

> "On January 31, 1944, an invitation to bid on the manufacture and assembly of the AT-3 mine was sent by the Pittsburgh Ordnance District of the War Department to Shenango. This was the first *official* notice received by Shenango from the Ordnance District relative to the program, *although Shenango officers had heard rumors that other ceramic manufacturers were engaged* in such a program for the government." (italics ours)

The Trial Court did not contradict itself!

The opinion expresses astonishment (Appendix A, p. 11) that Shenango accepted the mine contract "only sixteen days after it rejected the same contract." First, it was not the same contract, for the involved procurement and intricate assembly was to be performed by Castle. Second, in war time a lot can happen in 16 days. After Feb. 5, 1944, when Shenango's Board declined the contract, Treloar and Smith Jr. worked against time to visit other manufacturers, line up space, contact suppliers, prepare and submit a bid, etc. By Feb. 21, 1944, Pittsburgh Ordnance was ready to award the contract to Castle! The opinion fails to mention a really astounding fact, i.e., that, starting from scratch after Feb. 6 or 7, 1944, Castle, mainly through Treloar and Smith Jr.'s round-the-clock activities, started shipping completed mines on May 18, 1944, and by July 31, 1944, had delivered the 100,000 mines called for in the contract, without a single rejection! (299aa, 301aa, 297aa).

The Court of Appeals relied on the case of *Tenth National Bank v. Smith Construction Co.*, 242 Pa. 269, as controlling. The Trial Court correctly ignored this case although plaintiff-respondent cited it repeatedly. There, the outside company performed no substantial services whatever, and was set up merely as a sham to divert profits. To hold that case applicable completely disregards not only

the Trial Court's findings but also the extraordinary and highly complimented services of Treloar and others in making the project a success and in fact, saving the whole land mine program. Shenango had no Treloar, or anyone even approaching his type of dynamic genius (257aa).

Finally, the opinion fails to comprehend or consider Smith Jr.'s utter lack of a motive to divert anything from Shenango. In January 1944, Smith Jr. held 419 shares of Shenango stock, or about 22% of the outstanding 1907.5 shares; his 2 daughters and wife held another 250 shares, for a combined total of 669 shares, or about 35% of the total. It is difficult to see where he would benefit by taking profits via Castle rather than via Shenango. As a stockholder of Shenango, he would have no personal liability, but as a general partner of Castle, his entire fortune (including his Shenango stock) would be at stake. Naturally, if the other directors of Shenango had taken a part in Castle, Smith's participation in Castle would have been reduced pro rata. As it developed, Castle's original bid included a 10% estimated profit on the first contract, or $73,300 (367aa). Smith, Jr. and Treloar were to divide equally 50% of the Castle profits in lieu of salary; thus, Smith Jr. could expect 25% of the *estimated* Castle profits or $18,325 *before* taxes, *if* it succeeded. If we add his wife's and daughters' Castle participation, about 15%, we get an aggregate amount of $29,000, or 40% of the *expected* Castle profit. There was no indication that there would be contracts in addition to the original contract. *By just sitting still*, Smith, Jr. and his family would get 35% of Shenango's profits; there is no reason why he should scheme to divert profits to get a maximum of 40% of Castle's profit and at the same time risk his entire fortune as a general partner. With the high war time taxes payable on any profits, the motives to divert are even weaker.

The Trial Court's findings of good faith were not erroneous, and were amply supported by the evidence.

The Court of Appeals' disagreement was clearly unwarranted. It is in strange contrast to the following excerpt from the Trial Court's Adjudication (275a):

> "Smith Jr.'s Estate and Zahniser have the burden of proving that the transactions which they entered into were done in good faith and that their acts were fair and free of fraud and consistent with the fiduciary obligation they owed to Shenango. See Hirshorn *v.* Mine Safety Appliances Co., 203 F. 2d 279 (3 Cir.). In this connection, as to the decision made soon after February 5th, *there is not a shred of evidence* which arises contemporaneously with the events and actions which took place, showing that Smith Jr. was disloyal or motivated by self-interest in reaching his own conclusion and in reporting to the other members of the board that it was best that Shenango not participate in the mine program. Plaintiffs' evidence on that score comes only from three exhibits, which are summaries made after the events occurred, and upon which little probative value is placed because of the purposes for which they were prepared.
>
> "Smith, Jr.'s deposition, and Zahniser's and Treloar's testimony indicate honesty of purpose in the decision reached. The testimony of Higgins and Love, who did not participate in Castle, is likewise clear and explicit on this point. All the directors were in accord on the subject, and according to Love, who was disinterested, Smith Jr. made no recommendation apart from the report made by himself, Zahniser and Love. There is no evidence whatsoever apart from the renegotiation exhibits, which ties in the previous activities of Smith Jr., Treloar and Pfau with a nonmagnetic mine. It is clear and proven as an undisputed fact that the letter of January 31, 1944, from the Pittsburgh Ordnance District to Shenango was the first communication or actual notice to Smith Jr. of the land mine program. The evidence is that he, Zahniser and Love, independently, but collectively, reached the same decision on inspection of Onondaga's operation. Their report to the other three directors and the then collective decision of the six members of the board rested upon the facts then before them, with no conflict of interest on any-

> one's part so far as the evidence shows. Their decision in the first instance then, is held to be one based upon the exercise of their business judgment alone. That judgment is not subject to attack by minority shareholders *because under the preponderance of the evidence they fulfilled the statutory duty required of them in that they did* ' * * * *discharge the duties of their respective positions in good faith and with that diligence, care and skill which ordinarily prudent men would exercise under similar circumstances in their personal business affairs.*' See Section 408, Pennsylvania Business Corporation Law of May 5, 1933, P. L. 364, § 408, 15 P. S. 2852-408." (italics ours)

III. A. In computing Castle's profits, the compensation paid to Smith Jr. and Treloar by Castle should have been credited as a proper expense of operation.

B. Shenango should not retain the profits of the land mine contracts and, at the same time, repudiate the contracts.

The Trial Court stated (417a):

> "I do not regard such a credit as proper under the facts of the situation."

The Court of Appeals affirmed this without discussion (Appendix A, p. 17). This holding is in direct conflict with the decision of the Court of Appeals for the 7th Circuit in the case of *Central Ry. Signal Co.* v. *Longden*, 194 F. 2d 310 (1952), which involved a diversion of a war contract.

The Trial Court found that Smith Jr. and Treloar performed all management and supervisory functions for Castle (294a). Since this was a partnership, no salaries as such were paid to them as partners. However, there was an agreement among the partners that Smith Jr. and Treloar should receive a total of one-half (or one-fourth each) of the net partnership profits in lieu of salary (221-222aa); under this agreement each received, after renegotiation, $42,765. (367aa, back). There is no question that

if Castle had been a corporation, the salaries paid them as the principal executive officers would have been deducted before determining the net profits which Castle was obligated to repay to Shenango.

It would be unfair for Shenango, which itself made a profit of $248,587.58 to recover the entire profit of Castle without any deduction for the invaluable services of Smith Jr. and Treloar. To do so would enable Shenango to obtain these services free.

The Trial Court found both of these men free from fraud, industrious and patriotic (412a, 414a). Yet, even in cases where there was grossly fraudulent conduct, the courts have recognized the propriety of allowing compensation for services.

In *Central Ry. Signal Co.* v. *Longden*, *supra*, defendant Longden was president and dominant director of plaintiff Signal Co. He organized a personally owned company (Victory Corp.) and took for it a corporate opportunity of Signal Co. by misrepresenting it as a subsidiary of Signal Co. These proceedings were concealed from his directors. The lower court of course, found him guilty of a breach of his fiduciary duty to Signal Co., and directed that he pay all profits from the transaction, including the salaries he received from Victory Corp. The Court of Appeals, however, in spite of his concealment, misrepresentation, and fraudulent conduct, said (p. 323):

> "The trial court ordered Longden to repay to Victory the salaries drawn by him as its president during the years of its operation and thereafter from September 1942 to June 30, 1949, totalling $84,000. There is no evidence that Victory's operations were not properly managed. They involved production of some $5,000,000 worth of ammunition for the United States. Such undertakings are not self-operating; they involve tremendous executive and administrative activities. Longden, president and general manager discharged those functions. No complaint is made of his efficiency, his ability or his

> success. Though we agree that the earnings of Victory belong to plaintiff, we can conceive of no reason in equity why the reasonable actual costs of management, administration and production, from which sprang the profits, should not be allowed. These include the salaries and wages of all contributing to the final result,—a profitable operation. Those expenses, those salaries, would have had to be paid if plaintiff itself had conducted the enterprise; they are a part of the cost of goods sold. . . . We know of no reason in equity why any of this compensation paid to him by Victory between January 1, 1942 and June 30, 1949 should be repaid. The chancellor should have allowed the reasonable cost of the undertaking, including reasonable salaries for the executive officers. Inasmuch as no attack is made upon the reasonableness of the sums paid, equity demands that the judgment for repayment of salaries paid to Mr. Longden be reversed. Otherwise plaintiff would be unduly enriched."

The same principles apply to partnerships: *Edelson v. Bernstein, et al.*, 2 D. & C. 2d 443, affirmed on opinion below, at 382 Pa. 392 (1955).

It would be clearly inequitable to enrich Shenango unjustly by giving it the entire profits of the Castle operation without allowing fair compensation for the management services of Smith Jr. and Treloar which created those profits. This is a substantial matter: the compensation to Smith Jr. and Treloar was $42,765 each, or an aggregate of $85,531 which, with 3% interest from 1944 to July 27, 1959 would total around $112,000.

It is also repugnant to justice and fair dealing that a party retain the benefits of a transaction and at the same time repudiate that transaction as respects the rights of others thereunder. *Presbyterian Board v. Gilbee*, 212 Pa. 310, 314, 61 A. 925 (1905); *Cameron v. Christy*, 286 Pa. 405, 411, 412, 133 A. 55 (1926); *Ketcham et al., Aplnts. v. Conneaut Lake Co.*, 309 Pa. 224, 232, 233, 163 A. 534 (1932); *Bailis et al. v. Reconstruction Finance Corporation*, 38 F.

Supp. 721, 725, affirmed 128 F. 2d 857 (C. C. 3, 1942). If Shenango repudiates this transaction, its $248,587.58 of profits should be a credit against any recovery from Castle.

IV. Plaintiff-respondent stockholder was guilty of laches in waiting nearly 6 years before instituting action.

The Trial Court disregarded the question of laches. The Court of Appeals in its interim opinion stated (347a):

> "Laches is not an element in the pending litigation. Shenango's right to recover at law was governed by the Pennsylvania six year statute of limitations. The action before us was commenced well within that period."

At that stage of the proceedings, defendants' evidence had not been developed. To hold that only the Statute of Limitations is applicable is in conflict with the decisions of other Courts of Appeals and also of the courts of Pennsylvania.

Plaintiff-respondent's familiarity with the Shenango-Castle joint enterprise from 1944 on (149aa) and her bargaining activities where she asked a fantastic price for her Shenango stock (373aa) in the years preceding the filing of this action in January, 1950 are clear. The cause of action, if any, arose no later than February 21, 1944, the date when the Shenango directors (including plaintiff's husband) approved the Army's request that Shenango be substituted for Castle as prime contractor (40aa). She offered no explanation for her delay in bringing suit (67aa); and, in fact, did not take the witness stand in spite of the admission of her counsel that her testimony would be relevant to the question of laches (94aa).

In *Kinter, Appellant* v. *Commonwealth Tr. Co.*, 274 Pa. 436, 118 A. 392 (1922), plaintiff stockholder accused defendant corporate officers of inducing him to sell his stock by concealing the fact that the corporation had secured valuable war contracts. Suit was filed 5½ years after

the sale of the stock but within the six year statute of limitations. The court said (pp. 439-440):

> "The decree must be affirmed on the ground of laches and it is unnecessary to consider other questions. He who would rescind a contract by reason of fraud must act promptly . . . In the instant case, for nearly six years after plaintiff gave the option and five years after he transferred the stock, he remained silent and inert . . . Equity will not lend its aid to one who has slept upon his rights until the original transaction is obscured by lapse of years and death of parties . . . The burden here was upon plaintiff to set out such facts as would excuse his laches; yet he does not attempt to do so."

See also *Hornsby et al. v. Lohmeyer*, 364 Pa. 271, 277, 72 A. 2d 294 (1950).

Plaintiff made no attempt to explain why she waited 5 years and eleven months to bring suit; intervenor Barkley did not join in the proceedings until after the six-year period had run. In the meantime, defendants paid income taxes on the profits received from Castle (176aa, 369aa, back) and the time for amending the returns passed; thus, they materially and irretrievably altered their positions. Moreover, Smith Jr. and Smith Sr., his father, died pending the trial of the case (57aa).

Voicing objections alone, without taking action, is not enough (173aa); in *Watts's Appeal*, 78 Pa. 370 (1875), the Court held that laches barred plaintiff from bringing suit some two years after the construction of the building of which he complained.

The Third Circuit Court of Appeals, in *Barr v. Pittsburgh Plate Glass Co., supra*, in dismissing a charge that directors should not participate in a project turned down by the corporation, stated at p. 98:

> ". . . It must not be overlooked, too, that in reference to the purchase of Tarentum the proceedings to set it aside, or to alter the terms thereof, were

not taken until after the lapse of more than two years from the execution of the contract, a delay which, of itself and unexplained, might be fatal to that portion of the plaintiff's complaint. *Oil Co.* v. *Marburg*, *supra*."

V. In this shareholders' derivative action an appeal is not properly maintained where plaintiff-respondent shareholder did not disclose to the Court of Appeals that she had disposed of the bulk of her Shenango stock after she had filed this appeal and before argument or decision.

This was brought to the attention of the Court of Appeals in a petition for rehearing and ignored without comment. The facts alleged, on information and belief, were that plaintiff, her two sons and her husband had sold 282 shares for $452,800, less nominal transfer taxes, and plaintiff retained about 3% of the total stock, or about 5% of one class of stock, evidently to comply with the Pennsylvania Act of 1945, P. L. 253, 12 Purd. Stat. 1321 as to minimum amounts of stock required to avoid the necessity of a bond for costs. This is in direct conflict with the spirit of Rule 23 of the Rules of Civil Procedure (28 U. S. C. A.). The jurisdiction of the Court of Appeals is in doubt whenever it appears that an appeal may be collusive, not in good faith, and improperly maintained. This matter should be settled by this Court.

Conclusion

For the reasons set forth above, this petition for a writ of certiorari should be granted.

Respectfully submitted,

LYNNE ANDERSON WARREN,
Counsel for Petitioners.

September 12, 1960.

Appendix A—Court of Appeals Opinion

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

Nos. 13,026, 13,027, 13,060, 13,061, 13,062

ALICE S. HIGGINS, PLAINTIFF, ON BEHALF OF HERSELF AND OTHER STOCKHOLDERS OF SHENANGO POTTERY COMPANY, SIMILARLY SITUATED; AND HILDA BARKBY, ADMINISTRATRIX OF THE ESTATE OF HARRY BARKBY, DECEASED,

Intervenor,

v.

SHENANGO POTTERY COMPANY, NOW SHENANGO CHINA, INC., A CORPORATION; JAMES M. SMITH, JR., GEORGE B. ZAHNISER, CHARLES W. READ, DANIEL H. TRELOAR, JR., ZENO J. PFAU, JOHN B. McCARTY AND ALVAH M. SHUMAKER, INDIVIDUALLY AND JAMES M. SMITH, JR., GEORGE B. ZAHNISER, CHARLES W. READ, DANIEL H. TRELOAR, JR., ZENO J. PFAU, JOHN B. McCARTY AND ALVAH M. SHUMAKER, TRADING AS CASTLE ENGINEERING COMPANY, A PARTNERSHIP, LYNNE ANDERSON WARREN AND PEOPLES FIRST NATIONAL BANK AND TRUST CO., EXECUTORS OF ESTATE OF JAMES M. SMITH, JR., DECEASED,

Defendants.

ALICE S. HIGGINS, ETC. AND HILDA BARKBY, ETC., APPELLANTS IN NO. 13,026 AND NO. 13,027

SHENANGO POTTERY COMPANY, NOW SHENANGO CHINA, INC., A CORPORATION, APPELLANT IN NO. 13,060

LYNNE ANDERSON WARREN AND PEOPLES FIRST NATIONAL BANK AND TRUST CO., EXECUTORS OF ESTATE OF JAMES M. SMITH, JR., DECEASED, APPELLANTS IN No. 13,061

GEORGE B. ZAHNISER, APPELLANT IN No. 13,062

APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF PENNSYLVANIA

Argued March 25, 1960

Before McLAUGHLIN, KALODNER and HASTIE, *Circuit Judges*.

OPINION OF THE COURT

(Filed May 10, 1960)

By McLAUGHLIN, *Circuit Judge*.

The facts in this case are set forth at length in Higgins, et al. v. Shenango Pottery Co., et al., 256 F. 2d 504 (3 Cir. 1958), but for clarity a resume is appropriate.

This is a derivative action brought by a stockholder of Shenango Pottery Co., a Pennsylvania corporation, (Shenango) engaged in the manufacture of chinaware. Several of the defendants were officers and directors of Shenango: James M. Smith, Jr., now deceased, son of the founder and Chairman of the Board, James M. Smith, Sr., was a director and president; George B. Zahniser, a nephew of Smith, Sr., was a director and vice-president; Charles W. Read, since dismissed as a defendant by stipulation, was a director and vice-president. The remaining individual defendants were in no way connected with Shenango: Daniel H. Treloar, Jr. was in the life insurance business; Zeno J. Pfau was an automobile dealer; Alvah M. Shumaker was an attorney; and John B. McCarty was a

bar manager. The principal plaintiff, Alice S. Higgins, daughter of Smith, Sr. and sister of Smith, Jr., is a minority stockholder of Shenango.

On January 31, 1944 the Pittsburgh Ordnance District of the War Department offered Shenango the opportunity to participate in a non-magnetic land mine program. The principal parts of the mine, the bell and base, were to be ceramic, large and heavier than ordinary dinnerware and involved an operation foreign to the manufacture of dinnerware, that of threading the parts to fit with other pieces. On February 5, 1944 Smith, Jr., Zahniser and James K. Love, the latter another director of Shenango but not a party here, traveled to the Onondago Pottery Company in Syracuse, New York to investigate the land-mine program already in operation at that firm. Based on this investigation they recommended to the remaining three directors, Smith, Sr., Jonathan Higgins, husband of the principal plaintiff and Charles W. Read, that Shenango refrain from entering the land mine program.[1] The considerations prompting this recommendation ostensibly were a complicated assembly operation, rigid government tests and a requirement of additional space and labor. As a result the Board decided it was not feasible for Shenango to bid for a mine contract.

Several days subsequent to the decision, Smith, Jr., Treloar and Pfau investigated the possibility of undertaking the manufacture of mines and, as a result, began formation of a corporation, Castle Engineering Company (Castle). Castle submitted a bid which was not acceptable to Pittsburgh Ordnance because Castle was not as yet a

[1] It was brought out at the trial, on cross-examination of Zahniser, that at this time Smith, Jr. believed the operation could be profitable:

"Q. Did he [Smith, Jr.] tell you that he believed that the assembly job could be done profitably? A. He did, he told me that he got that impression by his trip to the Onondago and to the Ohio Brass Company. * * *

Q. And that was after paying Shenango Pottery $2.00 a pair for the ceramic parts? A. That is correct."

corporate entity. It was then decided, allegedly at the instigation of Pittsburgh Ordnance, that Shenango's name be inserted in place of Castle and upon award of the contract to Shenango, to have it sublet to Castle. Smith, Jr. immediately telephoned Shenango from Pittsburgh and had the proposal put before the other five members of the Board who were present at Shenango. The Board approved. On this point, the district court found, as a conclusion of law, that the business judgment of the five board members was influenced by the knowledge that Smith, Jr. and two other directors and officers of Shenango, Zahniser and Read who had previously joined with Smith, Jr., Trefoar and Pfau, were interested in Castle. The contract was awarded to Shenango which in turn sublet it to Castle, with the exception of the part calling for the manufacture of the ceramic base and bell. These parts Shenango was to supply at two dollars for every pair accepted and paid for by the government. At this stage it would be well to outline the full import of that arrangement.

The government inspection of the land mines consisted of a waterproof test and a drop test. Five mines were submerged in water for twenty-four hours, at the end of which time they were disassembled. If any trace of water was found, ten more were put through the same test and if water was found in any one of the ten the entire lot was rejected. After that five mines were dropped from a prescribed height on to concrete. If there was a failure of any of the parts of more than one mine, ten others were tested. If three or more of the fifteen showed failure the entire lot was rejected. Castle contracted to have the inspection on the basis of a lot consisting of ten thousand mines. Thus if either test was failed the entire ten thousand mines would have been rejected and Shenango would not receive payment for any of the ten thousand pairs of bases and bells, which were the most expensive part of the mine. It should be further noted that although the contract was sublet, Shenango remained liable thereon.

Appendix A—Court of Appeals Opinion

Castle was reorganized into a limited partnership; Smith, Jr. and Treloar becoming the general partners and Zahniser, Pfau and Read, later joined by Shumaker and McCarty, being the limited partners. It had a stated paid-in capital of $50,000 of which only $32,200 was actually paid in by the end of the fiscal year, July 31, 1944. The question of the validity of the limited partnership was raised. However, it is irrelevant since in our previous opinion we stated that the liability of the limited partners for return of improperly received profits is not limited by the amount of their partnership contribution. 256 F. 2d at 510.

Castle drew heavily on the financial resources of Shenango, and in many of its negotiations used the name, reputation and credit rating of Shenango. The trial court found that even the bid submitted by Castle contained information descriptive of Shenango but the court felt the constant use of Shenango's name was merely carelessness; a conclusion not borne out by the record.

Castle subsequently was awarded two other contracts, one of which was terminated with a monetary allowance before any land mines were supplied under it, both of which contracts the court held were corporate opportunities diverted from Shenango. The total net profit to Castle was $326,603.71 in a little over nine months.[2] Eventually this was reduced, as excessive profit, to $181,603.71 on renegotiation by the War Contracts Price Adjustment Board. Shenango made a profit of $248,587.58 on the manufacture of the base and bell. This was not renegotiated. Defendants argue that Shenango's profit is proof that they had the common good in mind and that there was no improper diversion of corporate opportunities; that the land mine project was in reality a joint venture between Shenango and Castle. This argument can be dismissed forthwith. Leaving behind a portion of the spoils is hardly justifica-

[2] From this amount was deducted a $10,000 liquidation expense leaving a net operating profit of $316,603.71.

tion. It leaves unanswered much the same question as arose in Tenth National Bank v. Smith Construction Co., 242 Pa. 269, 287 (1913). There officers of the Smith Company formed a partnership, the Maryland Company, to furnish services and supplies to the Smith Company at a profit. The court stated:

> "* * * the 10 per cent. paid to the Maryland concern might have been saved to the Smith Company; in substance it was nothing more or less than a commission for services that could have been performed directly by the officers of that company. Again, if the Maryland Company could furnish coal and horses to the Smith Company at a profit, it has not been made plain why the men who constituted that concern did not perform this service directly as officers of the latter corporation, and thus save to it the amount of such profits. Cases may be cited where the officers of a corporation have been permitted to make and retain profits for themselves through the formation of outside agencies controlled by them, which profits they could have saved to their constituent company had their thought been only for its welfare; but in such instances the law has ceased to look at the mere form of the device employed —it now pierces through the surface and seizes upon the evils which lie within."

On January 5, 1950, after several futile demands that the Board of Directors act to recover profits diverted from Shenango to Castle, plaintiff instituted this stockholder's derivative action. At the close of plaintiff's evidence the district court dismissed the suit against defendants Pfau, McCarty and Shumaker under Rule 41(b), Fed. R. Civ. P. The plaintiff appealed and this court, in an amended opinion filed June 24, 1958, reversed and remanded the cause. 256 F. 2d 504. However, prior to our decision, the district judge on May 23, 1956 pursuant to a lengthy adjudication which include 111 findings of fact and 17 conclusions of law found defendant Treloar not liable on the merits and gave judgment against the Estate of Smith, Jr. and Zahniser, jointly

and severally, in the sum of $316,603.71 with interest at 6% which totaled $538,396.99. Then on October 3, 1956, the district judge granted a new trial on the issue of damages only. The matter came on for trial in March of 1959. Because of this court's remand, evidence was taken on the issue of liability of the defendants, Pfau, McCarty and Shumaker. And since final judgment had not been entered in favor of Treloar, the question of his liability was reopened.

On July 29, 1959 the district court entered an amended order for judgment again exonerating Treloar, Pfau, McCarty and Shumaker, and holding Zahniser and the Smith, Jr. Estate liable. As to damages the court determined these to be Castle's profit after renegotiation with the War Contracts Price Adjustment Board, namely, $181,603.71. It fixed the rate of interest at 3%, rather than 6%, from the date the profits were realized. Including interest, the damages amounted to $262,456.58.

Plaintiff appeals from that part of the judgment dismissing the defendants Castle, Pfau, Treloar, McCarty and Shumaker and reducing the amount of damages. Defendant Shemango appeals from the judgment dismissing the above named defendants. Defendants Zahniser and the Estate of Smith, Jr. appeal from the judgment entered against them. As set out in the opinion of the district judge, this litigation is in such posture that should we disagree with the judgment below or any part thereof, we may direct whatever judgment as is required by the evidence and the law.

The questions in the various appeals can be divided under three major headings: The liability of Zahniser and the Estate of Smith, Jr.; the liability of the other defendants; and the amount of damages.

Liability of Zahniser and Smith, Jr.

The trial judge considered the inspection and recommendations made by Smith, Jr., Zahniser and Love, and the

resulting action of the entire Board determining it would not be feasible for Shenango to enter the mine program as having been made in good faith and as a business judgment. However, the subsequent events: Smith, Jr. forming a company to pick up the opportunity rejected by Shenango on his recommendation and vote; Zahniser joining him and later Read; the Directors of Shenango, upon Castle's bid being rejected, reversing their previous decision and with knowledge that Smith, Jr., one of their number and son of the Chairman of the Board, was prime mover of Castle authorizing Smith, Jr., to bid in the name of Shenango for the benefit of Castle; these events, the court found, demonstrated that Smith, Jr. and Zahniser, knowing that either Shenango or Castle had a prospect of making a profit were then in a conflicting position and, being in a fiduciary relation to Shenango should have refrained from participating in Castle. The trial court went on to find that their association in Castle was a breach of a fiduciary duty but done in good faith.

We disagree. Considering those transactions following the original Board decision to reject the contract as separate and distinct from the events leading up to and including the original decision merely ignores the bad faith which permeates the entire scheme.

That the Board on February 5, 1944 rejected the mine program in good faith and as a business judgment is in no way dispositive; the important question is the good faith of Smith, Jr. and Zahniser in making the recommendation upon which the decision was based. This recommendation was, according to testimony of Zahniser, based on a half-day's inspection of the mine operation at Onondago Pottery Company. Yet, before organizing and submitting a bid for Castle, Smith, Jr. with Trefoar and Ptau, inspected the mine operation at Ohio Brass Company, Barberton, Ohio, determined the price per mine at which the Army intended to let the contracts, estimated at which price they could buy the ceramic parts and still make a profit, began planning for

the necessary equipment, contacted various suppliers of parts and machinery, determined the availability and price of parts and searched for available space needed for the assembly. Two of the three officers, Smith, Jr. and Zahniser, who made the recommendation to Shenango and voted on it subsequently formed Castle. According to Zahniser, the recommendation and decision not to participate were made because of the problems of space, availability of labor and the complexity of the assembly operation. These very problems were quickly overcome by Castle, and the trial court found as a fact that the project was well within Shenango's corporate capabilities. It is impossible to understand why these problems made it unfeasible for a large, financially sound corporation like Shenango to enter the program when the embryo organization, Castle, under the guidance of Shenango's president reaped a tidy profit in like circumstances.

Plaintiff introduced into evidence letters sent to the War Contracts Price Adjustment Board and a Petition to the Tax Court for redetermination on behalf of Castle, which indicate that Smith, Jr., Treloar and Pfau were interested in the mine program even before the opportunity was offered the Shenango on January 31, 1944. By letter dated January 19, 1946 Castle's attorney requested a review of the Adjustment Board's determination stating therein, in part:

> "The operations of the Company, which is a partnership, actually started early in January, 1944, through the individual efforts of Mr. James M. Smith and Mr. Daniel H. Treloar, Jr., the unlimited partners * * * They began devoting all of their time to setting up for production of the mines long before March 22, 1944, the date on which the partnership was formally organized * * *."

The Petition for redetermination to the Tax Court of the United States contained the following allegations:

"6. (o) The respondent erred in disregarding the fact that, although not then formally organized, the petitioner had actually been functioning and the petitioner's general partners has (sic) been performing services, since January, 1944.

7. * * * (a) * * * The members of the petitioner had been jointly engaged in preliminary work on said mine program since January, 1944."

The above was sworn to be a true statement by Smith, Jr., Treloar, Pfau, Zahniser, Read, McCarty and Shumaker.

A letter dated December 30, 1944 to the Price Adjustment Division of Pittsburgh Ordnance District signed by Treloar on behalf of Castle included the following:

> "In the latter part of 1942 and early 1943 James M. Smith, Jr., Zeno Pfau, and D. H. Treloar, Jr., were investigating the possible adaptability of china and porcelain to such war items as bombs, mines, etc. * * * During this formulative period no formal organization existed and all expenses resulting from these efforts were paid by the individuals mentioned above."

The trial court felt that the above were "* * * summaries made after the events occurred, and upon which little probative value is placed because of the purpose for which they were prepared." These were statements, one sworn, made to a government agency and the Tax Court indicating a pre-existing interest in the very program later rejected by Shenango on Smith, Jr.'s recommendation. This evidence was contradicted by the deposition of Smith, Jr. and the testimony of Treloar and Pfau to the effect that the land mine program was first discussed among the three, casually over lunch, sometime after Shenango rejected the opportunity. The trial court bolstered this claim in its adjudication stating: "It is clear and proven as an undisputed fact that the letter of January 31, 1944, from the Pittsburgh Ordnance District to Shenango was the first communication or actual notice to Smith, Jr. of the land mine

program." However, this was contradicted by the trial court itself in its finding of fact No. 73, that "At or about this time [late 1943 or January 1944 but prior to January 31, 1944] it was known a Shenango Pottery Company that a land mine using china parts was being made by Onondago Pottery Company."

Added to all of the above is the astounding fact of the Shenango Board of Directors suddenly accepting the mine contract, after a telephone call from Smith, Jr. only sixteen days after it rejected the same contract. Shenango, outstanding in its field, at the time the largest producer of pottery in the world, first refuses to enter into a contract because of the difficulties involved and immediately thereafter, agrees to accept full liability under the same contract, *the liability hinging solely on the success or failure of a new, untried firm existing only on paper.* It was as to this later decision that the trial court found the business judgment of the Board was influenced by the knowledge that three of the Board members were organizers and owners of Castle.

Officers and directors are deemed, by the law of Pennsylvania which controls, to stand in a fiduciary relation to the corporation. 15 P. S. § 2852-408. As pointed out in our previous opinion at pages 507 and 508:

> "They [the directors and officers] were bound to act in the utmost good faith. They could not deal with the funds and property of Shenango nor utilize the influence and advantage of their offices for any but the common good. If they made a personal profit through the use of Shenango's assets they were accountable for it to the stockholders; they were not permitted even to place themselves in a position which invited conflict between their self-interest and their integrity." (citing Lutherland, Inc. *v.* Dahlen, 357 Pa. 143 (1947); Bailey *v.* Jacobs, 325 Pa. 187 (1937)).

In view of all the circumstances we reaffirm what we previously said:

"Plaintiff's above detailed evidence clearly points to a conflict between the Shenango officer and director defendants' obligation to their company and their self-interest. That evidence indicates those defendants used most every element of Shenango but the hotel-ware products itself for their own selfish interest."

The actions of defendants, Smith, Jr. and Zahniser, while short of fraud or deceit, were in calculated indifference to the corporate common good. We agree with the trial court that both are liable but the further finding of good faith is clearly erroneous and is set aside.

Liability of the Other Defendants

We held in our first opinion that the limited partners would be liable, jointly and severally with the general partners irrespective of their limits of liability, if the partnership is found to be liable. 256 F. 2d at 509-510. However, the district court considered that the limited partners were not liable and "That being so, it necessarily follows that Castle Engineering Company as a partnership entity is not liable." That is the reverse of the proposition we set forth. The Uniform Partnership Act, 59 P. S. § 34 states: "Notice to any partner of any matter relating to partnership affairs, and the knowledge of the partner acting in the particular matter, acquired while a partner or then present to his mind * * * operate as notice to or knowledge of the partnership * * *." The evidence is indisputable that Smith, Jr., Zahniser and Read, the corporate fiduciaries, had knowledge or should have had knowledge of their breach of duty and such knowledge was acquired while partners in Castle and while acting in partnership affairs. This is knowledge of the partnership and "The partnership in such situation would be liable for any profits realized from a breach of their fiduciary duty by a number of the partners for the purpose of benefiting the partnership at the expense of Shenango." 256 F. 2 at

509-510. The general partner, Treloar, and the limited partners Pfau, McCarty and Shumaker are jointly and severally liable with Smith, Jr. and Zahniser for the profit improperly diverted from Shenango.

These latter four defendants are also liable on the theory of constructive trust:

> "Where a fiduciary in violation of his duty to the beneficiary transfers property or causes property to be transferred to a third person, the third person, if he gave no value or if he had notice of the violation of duty, holds the property upon a constructive trust for the beneficiary." Restatement, Restitution § 201(1). See Spivak *v.* Bronstein, 367 Pa. 70, 75-76 (1951); Columbia Cas. Co. *v.* Westmoreland Co., 365 Pa. 271, 274 (1950).
>
> "Notice need not be actual. A purchaser is chargeable with notice of the trust where the facts and circumstances existing at the time of the purchase, within his knowledge, are such as would put a man of ordinary prudence upon inquiry and require him to make an investigation, and he fails to do so * * * no particular kind of evidence is necessary to constitute notice." Cameron *v.* Peoples' Bank of Maytown, 297 Pa. 551, 556-557 (1929). Columbia Cas. Co. *v.* Westmoreland, supra at 274; Custis *v.* Serrill, 303 Pa. 267, 270 (1931).

In *Spivak v. Bronstein*, *supra* 74-75, a taproom and restaurant owner continued a partnership arrangement with the administratrix of his former partner's estate. There the court said:

> "The agreement was with a fiduciary whose limitations to enter into such a contract defendant was bound to know * * *. Defendant should have known that without approval of the court, the contract he entered into with the plaintiff afforded him no protection against anyone beneficially interested in the estate * * *. So also he was bound to know that the minor son of his deceased partner could act only through his lawfully appointed guardian. He was bound to know also that

the mother could not under the law have been appointed guardian because of incapacity both as parent and as administratrix."

The inquiry which faced defendants here was much less stringent than that demanded by the court in Spivak. "A person has notice of a fact if he knows the fact, has reason to know it, should know it, or has been given notification of it." Restatement, Agency 2d § 9(1).

> "A person has reason to know of a fact if he has information from which a person of ordinary intelligence * * * would infer that the fact in question exists or that there is such a substantial chance of its existence that, if exercising reasonable care with reference to the matter in question, his action would be predicated upon the assumption of its possible existence. The inference drawn need not be that the fact exists; it is sufficient that the likelihood of its existence is so great that a person of ordinary intelligence * * * would, if exercising ordinary prudence under the circumstances, govern his conduct as if the fact existed, until he could ascertain its existence or non-existence." Restatement, Agency 2d § 9, Comment (d).

Treloar, as a general partner, had all the facts at his command. The other three limited partners had knowledge of the circumstances sufficient to spur them to inquiry. They made little or no investigation.[3] They cannot be allowed to

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[3] John B. McCarty testified:

"Q. You knew he [Smith, Jr.] was an officer and director, did you not? A. I knew he was connected with the pottery, yes, sir.

Q. And you knew that Mr. Zahniser was an officer and director, did you know that? A. I know Mr. Zahniser was connected with the Pottery, but I didn't know he was an officer to be truthful with you.

Q. Did you know he was a director? A. No, I didn't.

Q. Did you know Mr. Reed was an officer and director? A. I knowed Mr. Read was, yes, sir.

escape responsibility because they, in effect; say they closed their eyes to the obvious. All are jointly and severally liable with Smith, Jr. and Zahniser.

Q. Mr. McCarty, knowing that Mr. Zahniser and Mr. Smith, Jr. and Mr. Read were connected with Shenango and were also connected with Castle Engineering did you do anything to try to find out what the facts were in the situation so as to determine whether it was all right to be in that land mine project? A. No, I didn't.

Q. You made no inquiry? A. I wasn't interested. I didn't know a thing about what went on with the land mines at all.

Q. Did you make any inquiry as to the relationship between Shenango and Castle Engineering Company? A. No, sir."

Zeno Pfau testified:

"Q. Did you know, Mr. Pfau, that Shenango Pottery Company did take the first land mine contract itself, did you know that? A. No. Yes, I did too.

Q. I beg your pardon. A. I believe I did. I believe I was told that they took it to hurry up the order, as I understand it. Now, I don't remember that in detail. I wasn't too much consulted on this.

Q. What is your best recollection as to what you were told about Shenango taking the first land mine contract? A. I possibly didn't know about it until after it happened. I don't know."

Alvah M. Shumaker testified:

"Q. Well, now, you say that you were aware of the possible conflict of interest but you came to the conclusion that in this particular case there was no reason to be concerned, or words to that effect, is that correct? A. Well, let's say words to that effect.

Q. Then your last answer was—— A. Yes.

Q. Now, I will ask you then; being on notice of a possible conflict of interest will you tell me in detail to the best of your recollection what inquiry you made in order to resolve in your mind the question so that you concluded that there was no danger from that conflict of interest? A. The information that I had from Smith; the information I had from Treloar; the fact that I had known of the pottery for some time and

(Footnote continued on following page)

Damages

In its opinion after the second trial the district court held that under the principle of unjust enrichment the actual profit received by Castle is the amount to be returned to Shenango. The court ordered judgment in the amount of $181,603.71, the amount of profit to Castle after renegotiation with the Price Adjustment Board. The plaintiff argues forcibly that the renegotiation was personal to Castle and should not be considered when determining the loss to Shenango; that Shenango could have made the same profit but because of its broader financial base the profit would not have been excessive. This fails to take into account that the $326,000 realized by Castle would be swelled by the $248,000 netted by Shenango on the production of the ceramic base and bell. Whether that would or would not have been renegotiated is speculative.

knew that they manufactured ceramics exclusively, and it was in my knowledge they never manufactured or assembled anything else. So far as going farther and asking questions, I asked no questions, but I felt that the information that had been furnished me and supplemented by the information of Mr. Zahniser at our meeting of March second, and supplemented by the unanimous resolution of the board of directors, as represented to me, satisfied me that the transaction was a good proposition for both Castle Engineering and Shenango Pottery.

Q. Then I think in the last answer you gave you were pushing the time back until after the directors' meeting. My question, Mr. Shumaker, was directed to what inquiry you made at the original conference concerning the land mine business on February 16 which was before that meeting took place on February 21. A. I accepted what Mr. Treloar and Mr. Smith told me about the arrangement which we have been discussing.

Q. Well, is it correct to say that on accepting the information given to you by Mr. Smith, Jr. and Mr. Treloar that you made no independent investigation or inquiry of your own? A. That is right. You mean at the time.

Q. At the time, which would be before February 21, 1944; is that correct? A. That would be correct."

The Renegotiation Act, 56 Stat. 245, 50 U.S.C. App. § 1191(4)(B), defines profits as "The excess of the amount received or accrued * * * over the costs paid or incurred with respect thereto." Excess profits have been defined as "those profits in excess of all the legitimate costs incurred in production, plus a normal profit, all of which are to be determined in accordance with designated formulas." Atkinson v. New Britain Mach. Co., 154 F. 2d 895, 904 (7 Cir. 1946). A method by which costs may be calculated is set forth in the Act. To determine the existence of excess profits, Section 4(A) requires consideration of six explicit factors and "such other factors * * * published in the regulations of the Board from time to time * * *." This Act was administered by the War Contracts Price Adjustment Board (50 U.S.C. App. § 1191(d)), now the Renegotiation Board (50 U.S.C. App. § 1217), which, like most other administrative agencies, was particularly adapted to the task for which it was created. On the other hand this court has no part in the actual renegotiation of wartime contracts. The Act provides that the Tax Court has exclusive jurisdiction to redetermine the amount of excess profit. 50 U.S.C. App. § 1191(c), (e). We possess no jurisdiction, except to review constitutional and jurisdictional questions. United States v. Martin Wunderlich Co., 211 F.2d 433 (D.C.Cir. 1954). What the plaintiffs seek is a determination by us whether the full profit in the hands of Shenango would have been renegotiated, and if so, in what amount. We could not do so with any degree of accuracy. Under the circumstances the loss to Shenango is at best a guess. It seems more equitable, and accurate, to award the amount by which the defendants were unjustly enriched; the renegotiated sum of $181,603.71.

On the second trial the district court also reduced the originally fixed rate of interest from 6% to 3%. The ruling was based on what "the sum involved would ordinarily have earned in the money market," during the period in-

volved. The court found that rate to be from 2½ to 4⅓% and concluded a rate of 3% would be fair. An excellent discussion of the trend of courts to fix interest at less than the legal maximum based on rates prevailing in the local money market is found in Speed v. Transamerica Corp., 135 F.Supp. 176, 199-201 (D.C. Del. 1955). On appeal we held that fixing the rate of interest is a matter peculiarly within the discretion of the court. 235 F.2d 369, 374 (3 Cir. 1956). The trial court in this instance used a correct standard in adjusting the rate. There was no abuse of discretion.

We have reviewed all of the remaining contentions of the parties, including the return of the salaries paid by Shenango to Smith, Jr. and Zahniser, defense of laches, and compensation sought for the services rendered by Treloar. The question of laches was passed upon in our prior opinion, 256 F.2d at 511. The other problems were properly decided by the trial court and need no discussion.

The judgment of the district court will be reversed as to defendants, Daniel H. Treloar, Jr., Zeno J. Pfau, Alvah M. Shumaker and John B. McCarty, individually, and as to Lynne Anderson Warren and Peoples First National Bank and Trust Co., as Executors of the Estate of James M. Smith, Jr., deceased, George B. Zahniser, Daniel H. Treloar, Jr., Zeno J. Pfau, John B. McCarty and Alvah M. Schumaker, trading as Castle Engineering Company, a partnership, and the case remanded to the district court with direction to enter judgment against all of said defendants and in favor of Shenango Pottery Company in the sum of $262,456.58.

The balance of the judgment of the district court will be affirmed. Costs to be taxed against the defendants.

A True Copy:

Teste:

Clerk of the United States Court of Appeals

Appendix B—Court of Appeals Judgment

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

ALICE S. HIGGINS (plaintiff), on behalf of herself and other stockholders of Shenango Pottery Company, similarly situated, and Hilda Barkby, Administratrix of the Estate of Harry Barkby, deceased (intervenor)

vs.

SHENANGO POTTERY COMPANY, now Shenango China, Inc., a corporation; James M. Smith, Jr., George B. Zahniser, Charles W. Read, Daniel H. Treloar, Jr., Zeno J. Pfau, John B. McCarty and Alvah M. Shumaker, individually and James M. Smith, Jr., George B. Zahniser, Charles W. Read, Daniel H. Treloar, Jr., Zeno Pfau, John B. McCarty and Alvah M. Shumaker, trading as Castle Engineering Company, a partnership; Lynne Anderson Warren and Peoples First National Bank and Trust Co., Executors of the Estate of James M. Smith, Jr., deceased

No. 13,026 and No. 13,027

ALICE S. HIGGINS, on behalf of herself and other Stockholders of Shenango Pottery Company, now Shenango China, Inc., similarly situated; and Hilda Barkby, Administratrix of the Estate of Harry Barkby, deceased,

Appellants,

No. 13,060

SHENANGO POTTERY COMPANY, now Shenango China, Inc., a corporation,

Appellant,

No. 13,061

LYNNE ANDERSON WARREN and Peoples First National Bank and Trust Company, Executors under the Will of James M. Smith, Jr., deceased,

Appellants,

No. 13,062

GEORGE B. ZAHNISER,

Appellant.

APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF PENNSYLVANIA

Present: McLAUGHLIN, KALODNER and HASTIE, Circuit Judges.

Appendix B—Court of Appeals Judgment

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the Western District of Pennsylvania, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby reversed in part and affirmed in part, and the cause remanded with directions to proceed in accordance with the opinion of this Court. Costs to be taxed against the defendants.

Attest:

IDA O. CRESKOFF
Clerk

May 10, 1960

Received & Filed
MAY 10, 1960

IDA O. CRESKOFF,
Clerk

Appendix C—District Court Opinion

IN THE

District Court of the United States

FOR THE WESTERN DISTRICT OF PENNSYLVANIA

ALICE S. HIGGINS, Plaintiff, on behalf of herself and other stockholders of Shenango Pottery Company, now Shenango China, Inc., similarly situated,

and

HARRY BARKBY, Intervenor

vs.

SHENANGO POTTERY COMPANY, now SHENANGO CHINA, INC., a corporation, and others,

Defendants.

CIVIL ACTION
No. 8432

OPINION

WILSON, District Judge

On April 26, 1956, in this shareholder's diversity action tried non-jury, findings of fact, conclusions of law, together with a discussion of the facts and principles of law involved were filed. During the trial before me and at the close of plaintiff's evidence, the action against three of the defendants, Pfau, Shumaker and McCarty, was dismissed under Rule 41(b). Plaintiffs appealed the dismissal as to the three-named defendants. The decision of the Court of Appeals reversing this court on the dismissal was handed down June 24, 1958. See *Higgins* v. *Shenango Pottery Company*, 256 F. 2d 504.

In the judgment entered by this court on April 26, 1956, Zahniser and the Smith, Jr. Estate were held liable to

Shenango in the sum of $316,603.71 plus interest at six percent running back to 1944. I found defendant Treloar not liable on the merits. However on application of defendants, a new trial was granted as to damages only, because it was felt that adequate consideration had not been given to the issue of damages in the trial of the case. Especially this court felt that further consideration should be given as to whether the renegotiated profits realized by Castle Engineering Company was the amount for which the defendants Zahniser and the Smith, Jr. Estate should be held responsible or whether the amount should be the gross profit of Castle before renegotiation. In March of 1959, the case again came on for trial on all remaining issues. On the issue as to the liability of Messrs. Pfau, McCarty and Shumaker, both sides presented evidence. Evidence was also presented as to the liability of defendant Treloar in view of the Court of Appeals' decision on this court's dismissal of Pfau, McCarty and Shumaker. The case against Treloar was open for all purposes because plaintiffs had pending and undisposed of motions for new trial as to the action against him. Also evidence was presented on the issue of damages, that is, the amount to which the plaintiff corporation was entitled, as well as the rate of interest and time from which the interest should be computed. At the second trial, the experienced counsel for the parties involved were given full opportunity to present their evidence on the disputed issues. Counsel were thereafter heard at oral argument and have filed their briefs which have been considered.

In reaching my decision, set forth herein, I have given full consideration to Judge McLaughlin's opinion, 256 F. 2d 504. As the facts have been found in detail in the adjudication filed April 26, 1956, and those findings having been buttressed by the evidence presented in the second trial, it is now felt that there is no present need to make detailed findings of fact and conclusions of law. The additional findings and conclusions necessitated as a result of the second trial

are found in this opinion as permitted by the provisions of Rule 52.

It is noticed that Judge McLaughlin says on page 508 of his opinion:

> "Since the orders of the district court do not set out the reasons motivating the dismissal, the only inference from the foregoing analysis is that the court found no liability made out against the partnership and therefore dismissed as to those defendants who could be liable only in their partnership capacity. Dismissal as to the other defendants must therefore have been denied because, though not liable in their capacity as partners, they could be held liable in their fiduciary capacities."

The foregoing quotation from the Court of Appeals opinion is the correct interpretation of this court's decision in dismissing the action against the three defendants named. In my prior discussion, page 28, I said:

> "The principles of law, as applied here, which hold Smith, Jr. and Zahniser liable to Shenango for the profits realized by Castle, exonerate Treloar and the other individual defendants. It is noticed again that the first information Treloar had regarding a land mine transaction was Smith, Jr.'s statement to him that Shenango had declined the opportunity. It bears repeating here that the decision by Shenango's board to decline the opportunity was made in good faith. There is certainly authority for the proposition that when a third person conspires with an officer to divert a corporate opportunity, he is as liable for the diversion as is the corporate officer. See *Jackson* v. *Smith*, 254 U. S. 586; *Irving Trust Co.* v. *Deutsch*, supra; *Austrian* v. *Williams*, 103 F. Supp. 64. See also *Restatement of Trusts*, Section 326, and *Restatement of Restitution*, Section 201. It is believed, however, that in this case Treloar had the right to rely upon the decision of the six members of Shenango's board. He was a complete stranger to Shenango. He engaged in no surreptitious activity with Smith, Jr.

to take the business away from Shenango. The policy of the law which defines the fiduciary's duties and obligations to the corporation and its shareholders, and under the facts here, requires that Smith, Jr. and Zahniser be held responsible, does not apply to a person in Treloar's position. The remaining individual defendants are in the same position as Treloar. It is noticed that Director Read was dismissed as a party defendant by stipulation of counsel. Some of the other defendants named were dismissed at the close of the plaintiffs' case. In any event, the individual defendants remaining in the case had lesser knowledge of the factual situation than Treloar and are not held liable in the decision reached."

It should be noticed here that Treloar's liability has not been passed upon by the Court of Appeals but he, being an active participant and one of the managing heads of Castle, is liable if anyone in Castle Engineering Company other than Zahniser and Smith, Jr. is to be held responsible. I have exonerated Treloar in my prior decision. I adhere to that decision. Zahniser and Smith, Jr. as officials and directors of Shenango were presented with a conflict of interest, and being fiduciaries under the statutory law of Pennsylvania they were precluded from participating in the Castle project. Whether their liability be founded upon a statute, or a breach of their fiduciary relationship to Shenango, or whether it is based simply on public policy, in any event it is not based upon fraud and deceit under the evidence in this case. For purposes of this discussion, their liability is in the nature of *mala prohibita* only. It should be stressed that there were six active directors of Shenango. The dominating personality on the Board, according to all of the evidence, was not Smith, Jr. but his father, James M. Smith, Sr. In no sense of the word could Zahniser and Smith, Jr. be characterized as dominant or controlling directors. On February 21, 1944, when the telephone call came from Smith, Jr., who was in the Ordnance Office at Pittsburgh, the others on the Board were called into session. They made the de-

cision for Shenango to submit the bid and to sub-let the assembly portion of the contract to Castle. At that point in the Board's deliberation on the question, the directors had the best interests of Shenango in mind and their decision turned out to be a profitable one in all respects. At that point, however, Zahniser and Smith, Jr. in the pursuit of this transaction were confronted with a stop sign. The law imposed upon them the duty of refraining from participating in the land mine transaction simply because it had been presented to Shenango. The question then arises whether the defendants, Treloar, Pfau, McCarty and Shumaker are contaminated by becoming partners with Zahniser and Smith, Jr. in the assembly of the land mines and thus liable for the profits made by Castle. I think the answer to the proposition stated is in the negative. That being so, it necessarily follows that Castle Engineering Company as a partnership entity is not liable.

The many decisions on this subject do not cover the precise point mentioned. It is noticed that the Restatement, Restitution, Section 201: "*Liabilities of Third Persons,*" refers to third persons doing business with fiduciaries and holds such a person liable "if he gave no value or if he had notice of the violation of duty." Counsel have cited no authority which goes so far as to hold that in the absence of fraud a person joining a director in a business enterprise turned down by the corporate directors becomes ipso facto liable to the corporation. In this situation, the authorities often stress the duty of making inquiry. On this feature of the present case, an inquiry by say defendant McCarty, who was a bartender by trade, would have disclosed the full information that the Board of Directors of Shenango had exercised their best business judgment in declining the opportunity in the first instance. It would also have disclosed that without being misled by Zahniser or Smith, Jr. or in any way being deceived by them, the Board at a later date concluded that the best interests of Shenango

were to be served by entering into the contract with the Ordnance Department and sub-letting a portion of the business to Castle. Defendants Pfau, and Shumaker a practicing attorney, knew of the foregoing factual situation and relying upon the directors' actions, joined in the Castle enterprise. Under the facts of the situation presented then, I conclude as a matter of law that the Castle partners, other than the two held liable, are not liable merely because of their association in the venture with Zahniser and Smith, Jr.

The point has been raised and also discussed in Judge McLaughlin's opinion that Castle partnership is liable because the assets of Shenango were in the first instance used as credit in establishing Castle as a going concern. It is true, of course, and the evidence shows, that once the venture commenced all the interested persons active in the management of both Shenango and Castle exercised their energies in all directions in order to make a success of the land mine contracts. Materials were difficult to procure. Shenango had ample credit. It was easy to do business in Shenango's name and that was done. But that method of operation was not a surreptitious one. No secret was made of it. From the commencement of the operation, it was just as much to the interests of Shenango that it be successful as it was to the interests of Castle. The venture proved a bonanza for Shenango as well as for Castle. The method of operation was done with the full cooperation of all members of Shenango's officers and directors. Judge McLaughlin in his opinion says on this subject:

> "They could not deal with the funds and property of Shenango nor utilize the information and advantage of their offices for any but the common good."

I hold that the method of doing business was for the

made a profit of $240,000 in less than one year on the transaction. Castle's profit before renegotiation was $316,603.71 and after renegotiation was $171,603.71. It is apparent therefore that the parties were in a business relationship in the nature of a joint venture or common enterprise. It should be observed, I think, that the parties were operating in war time. Conditions in business were far from normal. The individual plaintiffs in this case are far from generous in their appraisal of the motives of the Castle partners. Having heard all of the evidence, however, I am under the strong impression that the Castle partners were not only looking for a profit but also had a bona fide desire to further the war effort. The members of the Shenango Board were also motivated by the same considerations.

The evidence introduced in the second trial on behalf of defendants Pfau, McCarty and Shumaker showed that on their part, as individuals and partners, they had no voice in the inception of the transaction. They were merely innocent participants. It certainly appears unjust and inequitable that they be fastened with any of the liability incurred by Zahniser and Smith, Jr. At the conclusion of plaintiff's case, I concluded that there was no liability made out against these three defendants and after hearing their evidence, I am of the same conclusion. It is believed, however, that the case is in such posture that if the Court of Appeals disagrees with my evaluation and interpretation of the evidence then it may direct such a judgment as the evidence and the law requires.

Two matters remain for consideration. The first is the amount of the damages. In my prior decision, I concluded that the gross profit made by Castle, that is, $316,603.71, was the figure to be used but upon reconsideration of this matter and having in mind that what is presented is an issue of restitution because of unjust enrichment, I have concluded that the net figure after renegotiation is the

held liable. The evidence shows that on the first contract the gross profit to Castle was $148,541.13. This profit was reduced to $68,541.13. On the second contract before renegotiation, the profit was $168,062.58. After renegotiation the profit was reduced to $103,062.58. The total profit to Castle then amounted to $171,603.71. This figure is believed to be the one for which judgment should be entered in favor of Shenango against Zahniser and the Smith, Jr. Estate. If the principle is based on that of unjust enrichment, it must follow as a matter of logic that what was finally received as a profit is the sum to be returned to Shenango by the two defendants. Under the facts, the figure first paid to Castle by the government is simply a tentative amount subject to later renegotiation. It seems fair and just that the final settlement between he government and Castle should determine the amount of the liability. The final point for decision is the interest rate to be applied on the money found to be due and owing from Zahniser and Smith, Jr. Estate to Shenango and the date from which it should be computed. The cause of action is one founded on equitable principles. It is of course recognized that in breach of contract cases for damages incurred, the interest to be applied is the legal rate of six percent. See Wilson v. Homestead Valve Company, 217 F. 2d 792. It is believed however that in the instant case the application of equitable principles requires that the rate of interest be fixed at that rate which the sum involved would ordinarily have earned in the money market. The evidence shows that during the period involved, that is from 1944 to the present, Shenango could and did borrow considerable sums at interest rates ranging from two and one-quarter percent to six percent. The interest rate to be applied in this instance is not necessarily what Shenango paid for its loans but what the prevailing rate was in the Pittsburgh area. I find that rate to be from two and

comparable to the amounts involved here. I therefore conclude that Zahniser and the Smith, Jr. Estate should pay interest on money due Shenango at the rate of three percent per annum from the date that the profits were realized by Castle. Those dates were August 1, 1944 and November 1, 1944.

I have not overlooked the contention made by the defendants that the valuable services rendered by Treloar to Castle should be compensated for by way of reduction of the liability of Zahniser and Smith, Jr. I do not regard such a credit as proper under the facts of the situation. By the same token, I do not allow the defendants a credit because of the so-called $10,000 liquidation credit permitted the Castle partners in the computation of their income tax. Taxes paid by the various partners do not affect the liability of Zahniser and Smith, Jr. Further, plaintiffs sought to have the court surcharge the Smith Estate for the salary received by Smith during the period when he was devoting time to the Castle enterprises. This claim has been rejected because the evidence shows that Smith, Jr. also devoted time to Shenango's affairs and that Shenango during the same period of time did not suffer from any lack of attention by Smith, Jr. It was making a good profit. It is impossible under the evidence to divide up Smith's time between Shenango and Castle. It is believed in this respect that the plaintiffs had the burden of showing by the preponderance of the evidence that Smith, Jr. did not earn his salary paid by Shenango during this period. I find that plaintiff's burden was not met in this regard.

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Supreme Court of the United States

OCTOBER TERM, 1960

NO. 413

LYNNE ANDERSON WARREN and PEOPLES FIRST NATIONAL BANK AND TRUST COMPANY (now PITTSBURGH NATIONAL BANK), Executors of Estate of JAMES M. SMITH, JR., Deceased, Petitioners,

v.

ALICE S. HIGGINS, on Behalf of Herself and Other Stockholders of SHENANGO POTTERY COMPANY (now SHENANGO CHINA, INC.), similarly situated, HILDA BARKBY, Administratrix of Estate of HARRY BARKBY, Deceased, and SHENANGO CHINA, INC., Respondents.

NO. 414

GEORGE B. ZAHNISER, DANIEL H. TRELOAR, JR., ZENO J. PFAU, JOHN B. McCARTY and ALVAH M. SHUMAKER, Individually and as Some of the Members of Castle Engineering Company, a Limited Partnership, Petitioners,

v.

ALICE S. HIGGINS, on Behalf of Herself and Other Stockholders, HILDA BARKBY, Administratrix of the Estate of HARRY BARKBY, Deceased, and SHENANGO POTTERY COMPANY now SHENANGO CHINA, INC., Respondents.

BRIEF IN OPPOSITION TO PETITIONS FOR WRITS OF CERTIORARI

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COUNTER-STATEMENT OF THE CASE*

This is a stockholder's derivative action filed January 5, 1950 to recover for Shenango Pottery Company

*References to the Appendices to the Petition filed herein are to the specific Appendix and page.

References to the Joint Appendix for Appellants in the Court of Appeals are by page numbers followed by "a".

References to the Consolidated Appendix for Appellants in the Court of Appeals, are by page numbers followed by "aa".

(hereafter called "Shenango") damages arising out of breaches of fiduciary duty by James M. Smith, Jr., its president, George B. Zahniser, its vice president in charge of manufacturing, and Charles W. Read, a vice president, all of whom were also directors. Daniel H. Treloar, Jr., Alvah M. Shumaker, Zeno J. Pfau and John B. McCarty, though not connected with Shenango, participated in those breaches of fiduciary duties. All were named defendants below.

The executors of the Estate of Smith, Jr., are the petitioners at No. 413 October Term, 1960. The other individual defendants (with the exception of Read who was dismissed when service could not be made on him) are the petitioners at No. 414 October Term, 1960.

The breaches of fiduciary duty involved the diversion of a corporate business opportunity, presented to Shenango in 1944, to profitably assemble various component parts into non-metallic land mines for the United States Army (i.e., Ordnance Department) (328a, 329a). That opportunity was diverted to the defendant business organization known as Castle Engineering Company (hereafter called "Castle") (330a), which the individual defendants formed specifically and solely to take up and handle the diverted opportunity (69a, 70a, 166a). The breaches also involved Shenango's actually taking a Government contract for the benefit of Castle and furnishing Castle with the use of Shenango's name, credit, funds, property and personnel to enable Castle to perform the assembly project which was diverted to it (313a-327a).

At the time of the breaches (i.e., 1944) Shenango's total of 1907-½ shares of stock was distributed among

fifty-three shareholders, but more than half (1053 shares) were owned by Smith, Jr., Zahniser, Read and their families (233a, 234a, 312a). It had six directors, including Smith, Jr., Zahniser and Read (265a).

The shareholders, as such, had for a long time been denied all rights in connection with the company's operations and were furnished with no information. No shareholders' meetings were held from May 15, 1931, until February 4, 1949 (313a). Minority shareholders who attempted to secure financial information were informed that it was none of their business (113a-115a), and in one meeting were ordered how they should vote (114a).

At that time (1944) Shenango was the world's largest producer of vitrified china (i.e., ceramic ware) and made hotelware and dinnerware (Ex. 293, p. 19). It had 2400 employees and a 900,000 square foot plant covering sixteen acres in New Castle, Pennsylvania (212a; Ex. 293, p. 20). It had production lines, machinery, conveyors, kilns (some mechanically operated—which Shenango had built itself), a machine shop, machinists, an engineer, and lathes that could be and were devoted to making machines (85a, 86a). It had space available to take on the assembly process (303a). It was financially sound with available resources (303a).

On the other hand, the Castle organization went through several stages. It was first an informal organization (Pltf. Ex. 11, 162a; Pltf. Ex. 12, 166a; Pltf. Ex. 15, 176a). At one time it was proposed that it function as a corporation (32a-35a) but on February 21, 1944, that corporation was not yet in existence (35a). Finally, on March 22, 1944, a so-called limited partnership was formed (Pltf. Ex. 1, 147a-150a).

However, from January, 1944, on (Pltf. Ex. 12, 166a); those interested in Castle included Smith, Jr., Zahniser, Read, Treloar, Jr., an insurance agent (59a), Pfau, an automobile dealer who had other war work (365a), Shumaker, an attorney (353a, 354a), and McCarty, a bar manager (64a).

The non-metallic land mine business began in the spring of 1942, when the United States Army initiated a project to develop a non-metallic, non-magnetic, anti-tank land mine (Defendants Ex. 12, 256a). At that time Onondaga Pottery Company, an organization similar to Shenango and Shenango's largest competitor in its ordinary business (76a, 77a), was called in by the Government, given a general idea of the type of land mine wanted, and asked to take on a research and development contract to develop the product which the Army desired. Although Onondaga had never engaged in that type of work before, it took on the project and by January, 1943, developed the plans for such a mine. The main and largest parts of the mine were a ceramic bell and base, which were assembled with a number of smaller non-metallic pieces and the whole assembly encased in a waterproof covering (294a, 295a).

Because the ceramic bell and base were the limiting parts (i.e., those most difficult to obtain), in 1943, additional research and development contracts were given to others, including Ohio Brass Company (Def. Ex. 12, 256a, 257a).

All the research and development contracts were awarded by the Government with the understanding that, inasmuch as the project was for the United States and for the war effort, all the experience, techniques and

background would be made available to any new producers later coming into the field (36a, 37a, 299a).

By the latter part of 1943 and early 1944, all of the research and development contractors had developed a mine, had installed the production lines to produce it and had a complete list of suppliers of the non-ceramic parts. All were assembling the entire land mine with ceramic parts manufactured by themselves and other parts purchased from other suppliers. The assembly process merely involved fitting together machined parts designed to be so fitted (294a-297a). No special type of plant space or skilled personnel were required (297a).

In 1942 and early 1943, about the same time the land mine was being developed, Smith, Jr., Treloar and Pfau had investigated, for themselves, the possible adaptability of china and porcelain to such war items as bombs, mines and similar objects. Smith, Jr., had developed an idea for an aerial practice bomb made of cast gypsum and cement and they had presented the idea to procurement agencies (Pltf. Ex. 15, 175a, 176a).

Materials were plentiful and the labor required for such an operation sufficiently abundant to make the operation attractive. However, their efforts proved fruitless. During that period, no formal organization involving the three named defendants existed but eventually they were a part of the Castle organization (Pltf. Ex. 15, 176a)

Smith, Jr., was particularly interested in war work and, on a number of occasions, visited a war project in which Pfau had an interest (366a, 367a).

In late 1943 or early 1944, after the Pittsburgh Ordnance District had surveyed the area and found that

Shenango (but not Castle, which was not even formally in existence then) was a possible supplier of land mines, it contacted Shenango to see if Shenango were interested in producing mines (75a, 83a, 298a). About the same time, Smith, Jr., had personally manifested an interest in the land mine business (Def. Ex. p, 254a).

On January 31, 1944, Shenango was sent plans for the mines and was requested to advise the Pittsburgh Ordnance District if it were interested in producing mines (Pltf. Ex. 161, 220a). At that time Shenango was advised by the Pittsburgh Ordnance District that it would be supplied with full information relating to the mines and their parts as well as their manufacture and assembly (including names of suppliers of parts) developed or to be developed by others in the program (299a).

Meanwhile, and although the Pittsburgh Ordnance District contacts were exclusively with Shenango (35a; Pltf. Ex. 2, p. 133 preceding 155a), Smith, Jr., of course, learned of the opportunity and began efforts to secure the land mine business (or the assembly portion thereof) for the Castle group (Pltf. Ex. 11, 162a; Pltf. Ex. 12, 166a, 167a). In January 1944, both he and Treloar were engaged in the preliminary work necessary to secure a contract for the Castle group (Pltf. Ex. 11, 162a; Pltf. Ex. 12, 166a, 167a). Nevertheless, during this period, all contacts were made in the name of Shenango (35a).

Before February 5, 1944, Smith, Jr., had evidently decided that the assembly of land mines constituted a valuable opportunity and had indicated to a prospective supplier of parts that Shenango would bid for it (Ex. 307, following 234a).

Then on February 5, 1944, Smith, Jr., Zahniser and James K. Love, another officer and director of Shenango, inspected Onondaga's land mine operation (292a) ostensibly for the purpose of determining the advisability of Shenango's participating in the business. However, neither Zahniser nor Mr. Love made any particular preparations for the trip, and neither of them considered the economic aspects of the land mine business (117a, 128a, 129a; Pltf. Ex. 316, 241a). Smith, Jr., however, concluded that land mine assembly would be profitable but did not then so advise anyone (129a; Pltf. Ex. 316, 241a). Nevertheless, while at Onondaga, Smith, Jr., Zahniser and Love ostensibly decided Shenango should not become interested in any aspect of the land mine business (106a). This decision was informally reported to the other members of Shenango's Board of Directors, none of whom objected to the decision (106a, 107a). No report was made to the shareholders (107a). There was no formal board action and the decision was never reconsidered in the light of later events (107a).

Thus, the first decision that Shenango would not be interested in the land mine business was made by two individuals already interested in securing the business for themselves (Pltf. Ex. 12, 166a), and was based wholly upon subjective considerations (303a).

Such decision ignored the fact that Onondaga, which was generally similar to Shenango, was assembling land mines; ignored the fact that Shenango had the capability of taking and performing a contract for the assembling of land mines (303a); and ignored the facts which made it possible for Castle to easily perform the contract with Shenango's furnishing ceramic parts, and with other assistance from Shenango.

Moreover, within ten days after the trip, Castle submitted a bid for 100,000 land mines which indicated that Castle expected to make a profit of $73,300 on the contract (Pltf. Ex. 132, 208a). Smith, Jr., told Zahniser (129a), Pfau (368a) and McCarty (371a) that the assembly was a profitable opportunity. Furthermore, that bid indicated that Shenango would supply the ceramic parts and was thus willing to assume the most difficult part of the business and the part that was the key to the business (76a, 78a, 120a, 121a, 131a, 132a, 173a; Ex. 132, opposite 208a; Def. Ex. 12, 256a, 259a, 260a). At no time did the Castle group ever consider an alternative source of ceramic parts (134a-135a). Shenango was always essential to the business (313a). Conversely, Shenango never evidenced any interest in selling ceramic parts to anyone but Castle.

The ceramic bell and base were much different than the chinaware ordinarily produced by dinnerware manufacturers. The mine parts were larger and heavier than dinnerware, and had to be threaded to fit with other pieces, a technique not involved in making dinnerware (296a). The threading was complicated by the fact that during the firing of the parts in kilns, shrinkage occurred (132a, Pltf. Ex. 13, 173a).

Shortly after the return from Onondaga Pottery Company, and despite any ostensible decisions made on that trip, Pittsburgh Ordnance District was almost immediately informed that Shenango itself was interested in bidding on mines (41a-43a; Ex. 2, p. 133, preceding 155a; 300a). Consequently, on February 8, 1944, Shenango was listed by the Pittsburgh Ordnance District as a prospective supplier of mines and Pittsburgh Ord-

nance District, after confirming Shenango's interest, then sent Shenango a request for proposals and bidding instructions. (41a-43a; Pltf. Ex. 294. 223a-226a). Any such proposal had to be filed by February 15, 1944. Castle did not receive any request for proposals (35a). It was not even formally in existence.

On February 10, 1944, the request for proposals and bidding instructions were received by Shenango (Pltf. Ex. 294, 224a).

On February 11, 1944, (292a), Smith, Jr., Pfau and Treloar visited the Ohio Brass land mine operation, which was similar to that of Onondaga Pottery Company—i.e., Ohio Brass manufactured ceramic (i.e., porcelain). bells and bases and assembled the mines from those as well as purchased items (296a). On the evening of Febrauary 11, 1944, Mr. Hicks, a manufacturer of machinery, was called concerning the making of some machines for the proposed operation (133a, 292a). On February 12, 1944, Smith, Jr., and Treloar visited Pittsburgh Ordnance and that evening saw Mr. Hicks in order to have him build certain machinery for Shenango (133a).

Between February 8, 1944, and February 15, 1944, suppliers were contacted by Shenango or in Shenango's name (314a-319a).

No bid was submitted in Shenango's name, but on February 15, 1944, Castle Engineering Company, which was at that time merely a corporation in the process of being formed, submitted a bid for furnishing 100,000 land mines at a total cost of $733,400.00 in response to the request for proposals sent to Shenango on February 8, 1944 (Ex. 132, Opp. 204a to 210a). The bid desig-

nated Smith, Jr., as the bidder's negotiator, gave the bidder's address as "c/o Shenango Pottery Co., New Castle, Pa.," and contained information about the bidder (Castle) which was actually descriptive of Shenango. At the time the bid was submitted, Castle was not organized, had no assets, no facilities, no place to operate (its address was in care of Shenango) and no employees (133a, 134a).

The Castle bid listed Shenango as the supplier of the ceramic parts. Thus, by February 15, 1944, the Shenango decision that it not take part in the land mine business had been modified to the extent that it would undertake the production of ceramic parts for Castle. These parts were the most expensive component of the mine (179a; Ex. 132, opposite 208a) and their manufacture was not only extremely risky but also involved techniques unfamiliar to producers of dinnerware (76a-78a, 120a, 121a, 296a). Their manufacture would also interfere directly with the regular Shenango products, and require the diversion of personnel therefrom (120a).

Shenango's supplying ceramic parts was essential to Castle inasmuch as Castle never contemplated any other source for ceramic parts (134a. 135a). In making its decision to produce the ceramic parts, Shenango ignored the normal procedure of consulting with the head of the manufacturing division which would produce the item and preparing molds and trial samples to determine if the project were feasible (51a-54a). Shenango's decision to make the parts was made personally by Smith, Jr. and Zahniser (52a, 115a, 128a, 135a). Moreover, the price for them was set by Smith, Jr., and Treloar, at a price lower than Smith Jr., had wanted for Shenango (135a).

After, as well as before, the submission of the bid in Castle's name, extensive negotiations were conducted with suppliers of parts in the name of Shenango by both Smith, Jr., and Treloar (313a-323a) and such suppliers were led, or permitted, to believe that Castle was an adjunct of Shenango (284a, 285a, 287a), as were other persons (Pltf. Ex. 2, 155a; Pltf. Ex. 14, 174a).

Even though no contract had been awarded, and the only bid was in Castle's name, on February 18, 1944, Shenango placed on order for the conveyor ultimately used in the Castle assembly operations (318a). On the same date it also placed an order for 100,000 fuse adapters and 100,000 base plugs to be used in the assembly operation (317a). On February 19, 1944, Shenango placed an order for 100,000 diaphragms for the mine assembly (319a).

On February 19, 1944, Articles of Incorporation for the proposed Castle Engineering Company were executed (32a-35a). Its Certificate of Incorporation was not issued until February 25, 1944 (35a). The original directors of Castle included Treloar, Pfau, Zahniser, Smith, Jr., and Shumaker (33a, 34a). No capital was paid in and a total capitalization of only $50,000 was contemplated (Def. Ex. 9, 249a). The corporate form for business was abandoned early in March (78a), for tax reasons (356a) and or because of credit (Def.. Ex. 9, 248a).

On February 21, 1944, the Castle bid was rejected by the Pittsburgh Ordnance District, either because Castle's credit was not satisfactory or because it was not yet in existence (67a, 68a, 84a; Pltf's Ex. 132, opposite 204a). When the bid in Castle's name was rejected, Castle still had no money, no property, no assets, no employees, and no assured manufacturing site (133a,

134a). On the same date, at the request of Smith, Jr., Shenango submitted a bid for 100,000 land mines. Shenango took the contract so that Castle could perform it with Shenango to supply the ceramic parts (68a, 69a, 84a, 301a, 302a).

The arrangement was made upon the basis that the contract be assigned to Castle, upon its incorporation and with the understanding and condition that Castle Engineering Company purchase from Shenango Pottery Company the two china parts for the new land mine at a price of $2.00 per set of two pieces, f. o. b. Shenango Pottery Company (302a). There was no mention that Shenango would be paid only for parts incorporated in mines accepted by the Government (302a). Shenango did not, at that time, or at any other time, consider any alternative (107a, 109a, 110a, 123a-130a, 134a, 135a). Shenango was not supplied with the information developed by Smith, Jr., or others, and gave no consideration whatsoever to the risks it might take by contracting (e.g., the rigid tests involved), to the nature and capabilities of Castle, to the extent of its obligations or to the business possibilities of assembling the mines itself (123a-130a). Smith, Jr., insisted that it not do so (69a, 304a) as had Zahniser (116a, 120a). Shenango was then, as at all other relevant times, fully capable of handling the assembly of land mines (303a).

The Pittsburgh Ordnance District, at all times in considering the award, relied on the fact that Shenango was a responsible company capable of producing the mines (280a, 298a, 349a, 350a; Ex. 2 following 153a).

The Shenango bid was accepted by Pittsburgh Ordnance District on February 26, 1944, for the stated reason that Shenango was an "Established concern with

good management and an engineering staff capable of producing item." (Ex. 2, p. 131, following 153a). Subsequently, contract W-36-061-ORD-663, calling for the sale of 100,000 land mines at a total price of $733,400 was entered into between Shenango and the United States (304a). Under the contract all 100,000 mines were to be furnished prior to July 31, 1944 (Ex. 141). The contract was not assignable and was not assigned to Castle (Ex. 141; 81a, 83a). However, Castle assembled all mines under that contract, for the contract price, but no written contract was entered into between Shenango and Castle covering their relationship (37a, 83a).

The government test for acceptance of the completed mines required that they withstand a drop test and an underwater test, both of which were rigidly fixed and applied (Pltf. Ex. 13, 172a, 173a; 287a). Passage of neither test was controlled by the ceramic parts (287a, 288a). However, under the arrangement between Shenango and Castle, Shenango was only paid for ceramic parts included in land mines accepted by the Government (287a, 288a). Thus Shenango assumed a substantial portion of the risk incident to the success of Castle's assembly operation. The $2.00 price for its ceramic parts depended upon Castle's correct assembly of the mines, regardless of the quality of the ceramic parts Shenango furnished Castle (287a). That arrangement was unknown even to Zahniser (87a, 90a). It saved Castle several thousand dollars, even though no mines were rejected (Pltf. Ex. 11, 163a).

Following the submission of the Shenango bid, extensive negotiations with suppliers of items to be used by Castle continued in the name of Shenango (315a-

317a, 319a-322a). Shenango placed an order for assembly parts (316a) and also placed an order on March 3, 1944, under which it bought and paid for all fuse adapters used in completing the first contract as well as some used in completing the second contract (321a-322a). Shenango also bought and paid for a great quantity of items which it supplied to Castle, but for which it did not bill Castle until much later (322a, 324a). Neither Mr. Love nor Zahniser was advised or knew that Shenango was furnishing such help to Castle (130a, Def. Ex. 9, 246a, 247a).

The first capital contributions to Castle were not made until March 13, 1944, when $22,950 was paid in. An additional $9,250 was paid on April 8, 1944 (Pltf. Ex. 296, 230a). Although the certificate of limited partnership executed by the partners stated that $50,000 cash capital had been contributed (148a), the total contribution during the period of the first contract was only $32,200. The balance of the $50,000 capital was paid on August 18, 1944, after the successful completion of the first contract (230a).

All of the Castle partners knew that the land mine opportunity had first been presented to Shenango (80a, 355a, 357a, 367a), all of them knew of Smith, Jr.'s connection with Shenango (80a, 355a), all of them knew that ceramic parts were to be purchased from Shenango (80a, 355a), all of them knew that Castle was unsuccessful in securing a contract and that Shenango had taken the first contract enabling Castle to perform it (79a, 360a, 369a), and all of them were kept informed of the developments in connection with the land mine business (79a).

Castle assembled the land mines in an old skating rink leased on March 6, 1944 (293a). All of Castle's production employees, about 52 women (Pltf. Ex. 16, 181a), were previously inexperienced (Pltf. Ex. 15, 180a) and were secured through the United States Employment Service (82a, 83a). Castle's equipment consisted only of a non-motorized conveyor, work tables and two relatively small machines (54a-56a) which were essentially the same as those used at Onondaga and Ohio Brass Company (297a). The total cost of machinery and equipment used by Castle during the first contract was only $13,027.20 of which Shenango originally furnished machinery and equipment worth $3,926.83 (Pltf. Ex. 302, 231a). Some of Castle's machinery was made in the Shenango machine shop (53a, 54a). Castle's production line was developed by Smith, Jr. (Pltf. Ex. 16, 180a); and all executive and management functions were handled by Smith, Jr., and Treloar (Pltf. Ex. 12, 167a).

Smith, Jr., worked long hours at Shenango in developing a machine to make the ceramic parts and in training Shenango employees to make the ceramic parts to the required tolerances (57a, 76a-78a). The latter was difficult because the personnel were not used to close tolerances and had no experience in making threaded parts (77a). Zahniser also spent considerable time working on the ceramic part of business at Shenango (57a).

Castle began production of land mines in mid-May, 1944, and completed the first contract on time, by July 31, 1944 (Ex. 2, pp. 122-124, Ex. 15). Castle received information and help from the research and develop-

ment contractors which would have also been available to Shenango (37a, 299a).

During the period of preparation and production under the first contract, Castle received extensive help from Shenango. The $32,200 cash contribution of the partners (Pltf. Ex. 296, 230a) was far less than the $150,000 which was estimated as necessary for working capital (Pltf. Ex. 144, 218a) and unsuccessful attempts were made to borrow money from banks (Pltf. Ex. 15, 177a). Despite the need for funds, Smith, Jr., Treloar, Pfau and McCarty did not pay the $17,800 they collectively owed to the partnership on their capital contributions until after the first contract had been successfully completed (Pltf. Ex. 296, 230a). Beginning in March and continuing thereafter, Shenango built machinery for Castle (53a), furnished labor, materials of all kinds, parts for the assembly operation as well as ceramic parts (323a, 324a). None of these items were paid for until long after furnished and not until Castle had received sufficient funds from the delivery of land mines to the Government to enable it to do so conveniently (Pltf. Ex. 295, 227a-229a). Castle's indebtedness to Shenango was at least as high as $160,187.65 on one occasion (Pltf. Ex. 295, 227a). In most instances Shenango paid Castle for land mines before Shenango received payment from the Government and made payments without offsetting the very large amounts which Castle owed it (Pltf. Ex. 295, 227a, 326a, 327a). Some of the payments, especially those in June, were advances to Castle to cover checks which Castle had issued (96a-98a, 325a-327a).

Castle subsequently received two additional contracts for land mines, the first being given to Castle at

the request of Shenango (Pltf. Ex. 2, 151a, 152a). Receipts from the land mine business constituted Castle's only income (69a, 70a). Performance of the contracts was completed in October, 1944 (305a).

On efforts lasting less than ten months, with only the management services of Smith, Jr., and Treloar, Castle made $326,603.71 on an investment which never exceeded $32,200.

The Court of Appeals twice reviewed these facts and twice reached the same conclusion, best summarized by its own statement (Appendix A, pp. 11, 12):

> "Plaintiff's above detailed evidence clearly points to a conflict between the Shenango officer and director defendants' obligation to their company and their self-interest. That evidence indicates those defendants used most every element of Shenango but the hotelware product itself for their own selfish interest."

Both the District Court and the Court of Appeals agreed on most points, both legal and factual, presented by the case.

Both found that the opportunity to furnish non-metallic land mines to the Government was a corporate opportunity of Shenango (306a). Both courts found that the Government was willing, at all times, to contract with Shenango for such land mines (280a, 284a). They found that Shenango was capable of embracing that opportunity and of fully performing all aspects of the Government contracts involved (303a, Appendix A, p. 9). Both courts found that Shenango could have performed the functions actually performed by Castle (303a; Appendix A, p. 9).

Both courts below found that when that opportunity was first extended to Shenango, Smith, Jr., Zahniser and Love (another officer and director of Shenango), after examining the production facilities for non-metallic land mines in operation at Onondaga Pottery Company, recommended that Shenango not embrace the opportunity (264a; Appendix A, p. 3). Both courts below also found that, almost immediately after February 5, 1944, the defendants, and particularly Smith, Jr., were attempting to secure that very business for Castle (276a, 277a, 284a-286a, 314a-322a; Appendix A, p. 8). Both found that Smith, Jr., and Zahniser were instrumental in having Shenango furnish Castle certain ceramic parts for the mine, which were the most important, the largest and by far the most difficult and expensive parts (265a, 266a, 313a; Appendix A, p. 4).

Both courts found that, on February 15, 1944, Castle submitted a bid to the government to furnish it land mines, but that Castle could not secure a contract (301a, 313a; Appendix A, p. 3). Both courts found that, on February 21, 1944, Smith, Jr., Zahniser and Read (all officers and directors of Shenango and also interested in Castle) were instrumental in having Shenango take a contract for land mines, assume all responsibilities to the Government for its performance, and then permit Castle to perform those parts of the contract which Castle desired, even though on that date Castle was merely a "paper" company (301a, 304a, 338a; Appendix A, p. 11). Both courts also found that Shenango furnished the ceramic parts for the mine (the largest, the most expensive and the most difficult parts to make and obtain) under an arrangement whereby Shenango was only paid for the ceramic parts incorporated in completed

mines accepted by the Government. Both recognized that Shenango, therefore, assumed a specific substantial portion of the risk of Castle's assembly operations, in addition to the general risks arising from Shenango's responsibility to the Government for the entire perfomance of the first contract (287a, 288a; Appendix A, p. 4).

Both Courts below also found that, beginning in early February, 1944, and almost continuously thereafter, the name, the assets, the credit, the funds and the personnel of Shenango were used, in a myriad of ways, for Castle's benefit and to enable Castle to get into and perform the land mine business (313a-322a; Appendix A, p. 5). Both courts below found that as a result of this diversion of corporate opportunity, Castle made an operating profit of $326,603.71 on its land mine operations (later reduced to $181,603.71 by renegotiation), on an investment of ony $32,200, in the short space of about ten months, with a management consisting solely of Smith, Jr., Shenango's president, and Treloar, an insurance salesman (294a, 415a, 416a, 419a, 420a; Appendix A, pp. 5, 9).

The District Court and the Court of Appeals were in full agreement as to the applicable Pennsylvania law and that thereunder the existence of personal interests of Smith, Jr., and Zahniser (and Read), which conflicted with their fiduciary duties to Shenango, made them liable to Shenango because those personal interests were favored. (276a-288a; Appendix A, pp. 11, 12). The Court of Appeals further held that the use of the name, assets, credit, funds and personnel of Shenango for Castle's benefit, and therefore for the benefit of Smith, Jr. and Zahniser, involved further breach of fiduciary duty imposing liability.

The District Court in its final decision, and the Court of Appeals upon review, were also in full agreement as to the damages to be allowed Shenango, $262,456.58, and the factors, both factual and legal, to be taken into consideration in assessing those damages. Both courts agreed that no deduction should be allowed for any services of Smith, Jr. or Treloar. Both Courts below agreed that the action was not barred by laches under Pennsylvania law.

The Court of Appeals and the District Court disagreed on only two matters. The District Court, though finding that Smith, Jr. and Zahniser (as well as Read) breached their fiduciary duty to Shenango, concluded that they were acting in "good faith" when they did so; the Court of Appeals, after examining all of the evidence and findings, held that such a conclusion was "clearly erroneous." The District Court also held that the defendants Treloar, Pfau, Shumaker and McCarty were not liable; the Court of Appeals twice held that, under the Pennsylvania law relating to partnership, agency and notice, those defendants were also jointly and severally liable to Shenango.

ARGUMENT

Introduction

This case does not involve any question of Federal substantive law. It involves only the substantive law of the Commonwealth of Pennsylvania. The decision depends solely upon the application of that Pennsylvania law to the facts. Except to the extent that petitioners question the Court of Appeals' right to reject one finding of the lower court—that of the "good faith" of certain of the petitioners — no question of Federal law is even suggested. Significantly, as will be pointed out hereafter, that factual issue, sought to be made a Federal question, is immaterial to the decision of the case.

Petitioners request this Court to reverse the Court of Appeals' decision as to the Pennsylvania law. Petitioners then request this Court to sift evidence and to review certain findings of fact of the courts below. Therefore, rather than being a case appropriate for review by this Court, it involves issues which this Court has traditionally refused to review. The Courts of Appeals were created to decide finally cases of this type.[1] Review by this Court should, for that reason be denied. Further analysis of the specific grounds for review asserted by Petitioners will confirm the conclusion that the case is not one appropriate for review by this Court.

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1. Dissenting opinion of Mr. Justice Frankfurter in *Dick v. New York Life Ins. Co.*, 359 U. S. 437, 3 L.ed 2d 935, 79 S.Ct. 921.

I.

This Court should not review the holdings of the Courts below as to the applicable substantive law of Pennsylvania with respect to the fiduciary duties of corporate officers and directors..

All the petitioners request (pages 8 to 10 of the Petition at No. 413; pages 19 and 20 of the Petition at No. 414) this Court to review this case so as to establish or clarify a basic principle of law applicable to corporate officers and directors. Under *Erie R. Co. v. Tompkins*, 304 U.S. 64, 82 L.ed. 1188, 58 S.Ct. 817 (1938) Pennsylvania law is to be applied. Hence, this Court's function would only be to ascertain and apply Pennsylvania law. Any pronouncement by this Court on the substantive legal principles involved would merely decide this specific case for the parties hereto. It would not be binding upon the Pennsylvania courts, nor upon any other court applying state law, if a similar question arose.

Furthermore, because, quite properly, this Court limits its review to cases involving important legal principles which should be settled authoritatively for future reference, it should not review this case. The decision here will be of significance only to the immediate parties with respect to the facts of this case and the law of Pennsylvania. The case is in the Federal Courts only because of diversity of citizenship.

Moreover, as this Court has frequently pointed out, it will adopt the conclusions of a Court of Appeals as to the state law, particularly when the Court of Appeals sits in the state whose law is being applied. *Propper v.*

Clark, 337 U.S. 472, 93 L.ed. 1480, 69 S. Ct. 1333; *The Tungus v. Skovgaard*, 358 U.S. 588, 593, 3 L.ed. 2d 524, 530, 79 S. Ct. 503; *Skelly Oil Co. v. Phillips Petroleum Co.*, 339 U.S. 667, 674, 94 L.ed. 1194, 1201, 70 S. Ct. 876; *Spiegel's Estate v. Commissioner*, 335 U.S. 701, 93 L.ed. 330, 69 S. Ct. 301, 337. This is true even where the state law affects a Federal issue properly presented for review. *A fortiori* this is so where the issue is *purely* one of state law.

Both the Court of Appeals and the District Court below sit in Pennsylvania. Judges McLaughlin, Kalodner, Goodrich and Hastie of the Court of Appeals, as well as Judge Willson of the District Court, have had long experience with Pennsylvania law. Both courts had two opportunities to delve into and apply the Pennsylvania law. On each occasion, those courts, without dissent, recognized the same Pennsylvania law—that corporate officers and directors are prohibited from taking any action which benefits them when they have any interest which does, or which might, conflict with their fiduciary duty to their corporation. As the Court of Appeals further held, Pennsylvania law also precludes their profiting, individually, from any use of corporate assets or positions. Those principles of the Pennsylvania law are well established.[2] The Pennsylvania cases are clear that

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2. *Bailey v. Jacobs*, 325 Pa. 187, 189 Atl. 320 (1937), and *Lutherland, Inc. v. Dahlen*, 357 Pa. 143, 53 A.2d 143 (1947), are leading cases in this field. Other apposite cases are: *Weissman v. Weissman, Inc.*, 374 Pa. 470, 97 A.2d 870 (1953); *Weisbecker v. Hosiery Patents, Inc.*, 356 Pa. 244, 51 A.2d 811 (1947); *Gilmore v. Gilmore Drug Co.*, 279 Pa. 193, 123 Atl. 730 (1924); *Glenn v. Kittanning Brewing Co.*, 259 Pa. 510, 103 Atl. 340 (1918); *Porter v. Healy*, 244 Pa. 427, 91 Atl. 428 (1914); *Tenth*

a fiduciary may not even place himself in a position where self-interest might conflict with fiduciary duty.[3] Similarly, they prevent a corporate officer or a corporate director's profiting, in the least, from his position.[4] Nor is damage to the corporation necessary; personal profit alone brings liability.[5]

The correctness of the decision here is also apparent when Petitioners' argument is seen in true perspective. Essentially, their argument is:—officers and directors of a corporation may recommend, and help decide, that their corporation is not interested in a profitable opportunity though it is well able to handle it; thereafter, having done so, those officers and directors are then entirely free to consider the opportunity as their own and are also free to use the corporation, its name, credit, assets, funds and personnel, when and as needed to aid

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National Bank v. Smith Construction Co., 242 Pa. 269, 89 Atl. 76 (1913); *Douglass-Whisler Brick Co. v. Simpson*, 233 Pa. 515, 82 Atl. 759 (1912); *Commonwealth Title Insurance Co. v. Seltzer*, 227 Pa. 410, 76 Atl. 77 (1910); *Graham v. Cummings*, 208 Pa. 516, 57 Atl. 943 (1904); *Bird Coal & Iron Co. v. Humes*, 157 Pa. 278, 27 Atl. 750 (1893); *Hill v. Frazier*, 22 Pa. 320 (1853); Compare: *Chalupiak v. Stahlman*, 368 Pa. 83, 81 A.2d 577 (1951); *East & West Coast Service Corp. v. Papahagis* (No. 1), 344 Pa. 183, 25 A.2d 339 (1942).

3. *Bailey v. Jacobs, supra*, 325 Pa. at 194, 189 Atl. at 324; *Noonan Estate*, 361 Pa. 26, 63 A.2d 80 (1949); *Lutherland, Inc. v. Dahlen, supra; Weisbecker v. Hosiery Patents, Inc., supra.*

4. *Bailey v. Jacobs, supra; Lutherland, Inc. v. Dahlen, supra; Commonwealth Title Insurance & Trust Co. v. Seltzer, supra; Douglass-Whisler Brick Co. v. Simpson, supra.*

5. *Bailey v. Jacobs, supra*, 325 Pa. at 194, 189 Atl. at 324, 325.

them in securing and performing that opportunity for themselves. If such is the law, the shareholders in the corporations of Pennsylvania, and of the other states, are at the complete mercy of the managers of their investments. We, like the Court of Appeals for the Third Circuit and the United States District Court for the Western District of Pennsylvania, are certain that such is not the law of Pennsylvania.

Any review by this Court would, therefore, necessarily require affirmance of the judgment based upon application of Pennsylvania law to the facts. Hence no review should be undertaken.

II.

This Court should not review the findings of fact of the Courts below.

Petitioners urge this Court to review the decision of the Court of Appeals because, it is argued (pages 10 to 20 of Petition at No. 413; pages 10 to 18 of Petition at No. 414) that the Court of Appeals erred in holding that the District Court's finding of "good faith" was clearly erroneous.

As pointed out heretofore, a finding as to the "good faith" or the "bad faith" of any of the Petitioners is immaterial to the decision. The Pennsylvania law, as found by both the District Court and the Court of Appeals, imposes liability on any corporate officer or director whoever places himself in a position of potential conflict between self-interest and fiduciary duty and who then favors himself by his action. It also imposes liability whenever a corporate officer or director uses corpo-

rate assets or position for his own benefit. The courts do not attempt to weigh his motivation. For this very reason, the District Court found that Smith, Jr., and Zahniser breached their fiduciary duty even though it also found they acted in "good faith."

The Court of Appeals twice announced the same rule as that applied in the District Court when it said (Appendix A, p. 11):

> "'They [the directors and officers] were bound to act in the utmost good faith. They could not deal with the funds and property of Shenango nor utilize the influence and advantage of their offices for any but the common good. If they made a personal profit through the use of Shenango's assets they were accountable for it to the stockholders; they were not permitted even to place themselves in a position which invited conflict between their self-interest and their integrity.' (citing Lutherland, Inc. v. Dahlen, 357 Pa. 143 (1947); Bailey v. Jacobs, 325 Pa. 187 (1937))."

Accordingly, the review sought by petitioners would involve merely an academic discussion of the effect of certain evidence in the case. This Court has indicated that it does not exist for that purpose.

Even if the issue of "good faith" were material, a review would be merely to determine whether the Court of Appeals or the District Court correctly interpreted the evidence. No basic legal problem is presented for decision. Rule 52(a) permits a Court of Appeals to reverse findings of fact which it finds to be "clearly erroneous." That is what the Court of Appeals found here.

Moreover, as this Court held in *United States v. United States Gypsum Company*, 333 U.S. 364, 395, 92 L.ed. 746, 766, 68 S. Ct. 525 (333 U.S. at 395):

> ". . . A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed."

Analysis of its opinion shows that the Court of Appeals applied that very test in holding that the conclusion of "good faith" was clearly erroneous. It looked at the entire record. The significance of a number of related actions, taken over a short period of time, all having the same common denominator of favoring the self-interest of Smith, Jr., and his associates, was not lost upon the Court of Appeals. The use of Shenango's assets, name, credit, funds and personnel was placed in its true perspective. Such factors—occurring and recurring throughout the record—resulted in the inescapable conviction that the lower court's conclusion of "good faith" was clearly erroneous.

Thus—although petitioners attempt to create the contrary impression—petitioners' argument is supported solely by limited oral testimony of certain of the petitioners themselves, while the Court of Appeals' conclusion is supported by undisputed facts, as well as by a great number of documents taken from the petitioners' files and used in their own business, including their own statements, some made under oath. As Petitioners at No. 414 acknowledge (p. 11 of their Petition) where, as here, testimony conflicts with such documents the action of the Court of Appeals is proper. Compare *United States v. United States Gypsum Company*, supra.

This argument on "good faith," we believe, typifies the defense to this action. It consists largely of excoriating the Court of Appeals, and particularly Judge McLaughlin, for giving credence to the sworn and other written statements *of the petitioners themselves.* The success of petitioners' argument, oddly enough, depends upon establishing that the petitioners themselves lied in 1944 and 1946 in their statements to various renegotiation agencies. So viewed, the attempt to avoid the effect of those written statements by suggesting they were not contemporaneous with the events seems rather specious. In fact, they were far more contemporaneous with the events than any oral testimony offered in the 1950's. Treloar's letter to the Price Adjustment Division of Pittsburgh Ordnance District, in which he established the prior interest of Smith, Jr., Pfau and himself in securing war work of the very type later made available to Shenango, was dated December 30, 1944—within several months after production of land mines terminated (Pltf. Ex. 15, 175a-176a). The letter of Castle's attorney was dated January 19, 1946 (Pltf. Ex. 11, 161a-164a). The petition to the Tax Court, which established that activities on behalf of Castle began in January, 1944, was sworn to by all the petitioners on June 19, 1946 (Pltf. Ex. 12, 165a-169a). All this was long before the present action was filed and before the first letter on behalf of plaintiff below demanding redress.

The Court of Appeals quite properly concluded either that the documentary evidence was true, thus conclusively establishing "bad faith," or that, if not true, the individuals who prepared those documents were so loose with the truth that no confidence could be placed in their protestations of innocence—particularly when

such protestations were incompatible with acknowledged facts and other documentary evidence.

The argument on "good faith" is further typified by the reference to the testimony of Mr. Downie (p. 12 of Petition at No. 143). He did not corroborate Petitioners' position. His testimony clearly established that the Pittsburgh Ordnance District always considered Shenango as the responsible party (348a-350a).

The entire "good faith" argument may be evaluated by pointing out only a few examples of demonstrable inaccuracies in the petitions filed herewith.

The argument of Petitioners at No. 413 (p. 18 of that petition) that Smith, Jr., pledged his personal fortune to the venture, completely ignores the uncontradicted fact that when he, and his associates, caused Shenango to take the entire land mine contract and assume responsibility for 100,000 land mines at a price of $733,400, for *Castle's benefit,* it was then contemplated that Castle operate as a corporation with only $50,000 capital (Def. Ex. 9, 249a) (although $150,000 was estimated as the necessary working capital for the Castle venture (Pltf. Ex. 144, 218a). Only because certain suppliers refused to deal with the proposed corporation (Castle) was the partnership substituted (256aa). Thus Shenango was the unwitting beneficiary of the demand of *other suppliers.*

Likewise revealing is the assertion by Petitioners at No. 414 (p. 16 of that petition) that on February 21, 1944, "an effective assembly group had been formed by Castle" and (p. 17 of the same petition) that there was "money subscribed, there was chosen leadership and the

demonstration of their capabilities." For it is uncontradicted that at that time Castle had no money, no place to operate, no experience in assembly work, and no employees (133a, 134a).

III.

This Court should not review the determination of damages by the Courts below.

Petitioners ask this Court to review the question of damages, particularly suggesting error in the failure to allow a management expense to Smith, Jr. and Treloar (pages 20 to 23 of Petition at No. 413; pages 23 to 26 of the Petition at No. 414).

Both the District Court and the Court of Appeals held, under the law and the facts, that the proper damages were the profits of Castle after renegotiation, without any credits. Any legal problem would involve only Pennsylvania law. The factual matters were fully considered by the two lower courts and their concurrent findings should be accepted.[6]

Petitioners attempt to create an issue for review by pointing to an alleged inconsistency with the holding in *Central Ry. Signal Co. v. Longden*, 7 Cir., 1952, 194 F.2d 310. The argument ignores a fundamental fact. *Central Ry. Signal Co. v. Longden, supra* was not decided under Pennsylvania law. This case is to be decided under Pennsylvania law. If the two cases were inconsistent,

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6. *Graver Tank & Mfg. Co. v. Linde Air Products Co.*, 336 U.S. 271, 275, 93 L.ed. 672, 677, 69 S. Ct. 535; *Great A. & P. Tea Co. v. Supermarket Equip. Corp.*, 340 U.S. 147, 153, 95 L.ed. 162, 167, 71 S. Ct. 127.

this Court would not bring them into accord because, under *Erie v. Tompkins, supra*, it does not establish state law. It is for this reason that inconsistent Courts of Appeals decisions involving state laws do not warrant a review.[7]

However, the decisions are not inconsistent. A wide factual difference is apparent. Here Smith, Jr., was drawing a salary from Shenango. Had Shenango performed the contract, he would have received no extra compensation. The courts below apparently did not believe that Treloar's management services would have been essential had Shenango performed the contracts. Nor, apparently, did they value such services as do petitioners. Furthermore, such salary allowances were not taken into consideration in the renegotiation proceedings, which permitted Castle a net profit of $181,603.71 after expenses. Had such salary allowances been included as an expense, Castle would have been allowed the same, or possibly a higher, net profit. Hence, the net amount of profit would have remained the same and was the proper recovery to Shenango.

Moreover, as the Court of Appeals pointed out, Treloar was a direct participant in the breaches of fiduciary duty (Appendix A, p. 14). Thus the allowance of any return to him, whether by way of salary or of profit, would profit a wrongdoer. The law does not permit a wrongdoer to profit from his wrongful conduct.

The further argument that Shenango's profit from the land mine business should be offset against its recovery from Castle was fully answered by the Court

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7. *Ruhlin v. New York Life Ins. Co.*, 304 U.S. 202, 82 L.ed. 1290, 58 S. Ct. 860.

of Appeals when it observed that "leaving behind a part of the spoils is hardly justification" for taking the rest (Appendix A, p. 5). The Courts below properly recognized that all benefit of the land mine business—both the profit from the manufacture of ceramic parts and the profit from assembling land mines—should have gone to Shenango and would have gone to Shenango but for the breaches of fiduciary duty. Hence, no such credit is allowable.

Both Courts below, after an exhaustive review of the facts, concluded that no credit should be given against the recovery. To review this matter would merely involve a re-evaluation of the facts. We submit this Court should decline to do so.

IV.

This Court should not review the Court belows decision that the action was not barred by laches.

Petitioners suggest that this case should be reviewed because the action is barred by laches (pages 23 to 25 of Petition at No. 413; pages 20 to 22 of Petition at No. 414).

The Court of Appeals has twice held that under Pennsylvania law laches is not an element in this case (Appendix A, p. 18). As it pointed out in its first opinion (256 F.2d at 511), Shenango could have brought suit at law at any time within six years against the defendants. Therefore, the plaintiff stockholder could also bring suit at any time within six years. Otherwise, the defendants whose control of the corporation prevented its bringing action, could destroy the corporation's rights by their wrongful conduct in preventing institution of action

against them.[8] The cases cited by petitioners are inapposite.

Furthermore, the District Court refused to find any facts to support any holding of laches. This was not "clearly erroneous" and hence under Rule 52 (a) would be conclusive in any event.

Again all Petitioners seek is the review of Pennsylvania law and of the facts. No question of Federal law is presented. Hence, this Court should decline to review the matter.

V.

This Court should not review the case because one of the respondents sold some, but not all, of her stock.

Petitioner at No. 413 suggest (p. 25) that because plaintiff below, and members of her family, sold some of their stock after judgment was entered for Shenango and while the appeals were pending a review is justified.

Of course these matters are not of record. Even so, Plaintiff-respondent still retains, according to Petitioners, about 5% of one class of Shenango's stock and 3% of its total stock. Petitioners can point to no legal requirement that plaintiff own more stock than she does. It seems quite obvious that Shenango's right of recovery is not to be affected by the fact that, after judgment is

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8. See: *Strickler v. McElroy*, 40 Pa. Super., 277 (1909); *Galway v. Metropolitan Elevated Rwy. Co.*, 128 N.Y. 132, 28 N.E. 479 (1891); *Pollitz v. Wabash R. Co.*, 207 N.Y. 113, 100 N.E. 721 (1912); *Pfeiffer v. Berke*, 121 N.Y.S.2d 774, 779 (Sup. Ct. 1953); *Gross v. Price*, 127 N.Y.S.2d 729, 736 (Sup. Ct. 1953), opinion adhered to in 128 N.Y.S.2d 209, 212 (Sup. Ct. 1953), modified on other grounds 284 App. Div. 964, 134 N.Y.S.2d 649 (1954).

entered, the one protecting its interests sells some, but far less than all, of her stock.

This law suit has dragged on for over ten years. It is not usual that during such an extended period of time a shareholder may have occasion to change somewhat her shareholdings. The argument which attempts to destroy Shenango's right of recovery because of such a change typifies the petitioners' position here. They are desperately engaged in a final attempt to avoid their legal responsibility to Shenango, and to all of its shareholders, arising from the clear violations of fiduciary duty.

VI.

This Court should not review the holding of the Court of Appeals that the Petitioners are jointly and severally liable.

The Petitioners at No. 414 request review (pages 27 to 33 of their petition) because they have been held jointly and severally liable to Shenango. (The Petitioners at No. 413 have not raised this question.)

The District Court and the Court of Appeals have both held that the corporate officers and directors are jointly and severally liable for the breaches of fiduciary duty (417a-422a; Appendix A, p. 18). This is clearly the law of Pennsylvania.[9] Their decision should be accepted.

The Court of Appeals also held the other Petitioners (Treloar, Shumaker, Pfau and McCarty) jointly and

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9. *Fell v. Pitts*, 263 Pa. 314, 106 Atl. 574 (1919); *Cochran v. Shetler*, 286 Pa. 226, 133 Atl. 232 (1926); *Komenarsky v. Brode*, 307 Pa. 156, 160 Atl. 713 (1932).

severally liable as participants in a breach of trust, under familiar and well-settled rules of partnership and agency law (Appendix A, pp. 12, 13). It also held that they were liable on the theory of constructive trust (Appendix A, p. 13). The factual basis for its holding of liability included said other Petitioners' admissions of knowledge of circumstances amounting to legal notice of the breaches of fiduciary duty (Appendix A, pp. 14-16). Because those conclusions are well-supported by the authorities cited in the opinion of the Court of Appeals, they too should be accepted. Moreover, as the Court of Appeals pointed out, this ground of liability makes any consideration of the alleged limited partnership status immaterial (Appendix A, p. 5). Furthermore, said status would, in any event, be purely a matter of Pennsylvania law.

The fact that on March 22, 1944, (293a) the Petitioners attempted to form a limited partnership — although in fact and law, their failure to pay in their stated capital[10] prevented the formation of a valid limited partnership—can not affect the wrongful conduct which occurred theretofore and the damage to which Shenango became entitled as a result of that wrongful

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10. The assertion (p. 28 of petition at No. 414) that "The contributions were all fully made in time" is simply not accurate. The first capital contributions to Castle were not made until March 13, 1944 when $22,950 was paid in (Pltf. Ex. 296, 230a). An additional $9,250 was paid on April 8, 1944 (Pltf. Ex. 296, 230a). Although the certificate of limited partnership executed and *sworn to* by the partners— all the Petitioners here —stated that $50,000 cash capital had been contributed (Pltf. Ex. 1, 147a-151a), the total capital of $50,000 was not paid in until August 18, 1944 after the completion of the first contract (Pltf. Ex. 296, 230a).

conduct. The breach of fiduciary duty in diverting the corporate opportunity occurred in February, 1944. The law does not permit wrongdoers to arrange their affairs, after having committed a wrong, so as to limit the rights of the wronged party. Otherwise, wrongdoers might effectively destroy the right of recovery by carefully delineating responsibility to suit themselves. For this reason, Pennsylvania law holds that all who are members of a limited partnership which participates in wrongful conduct of the type disclosed here are jointly and severally liable.[11] Accordingly, this Court should not review this question.

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11. *Guillou v. Peterson*, 89 Pa. 163 (1879).

CONCLUSION

We, therefore, respectfully submit that this case is not one which should be reviewed by the Supreme Court of the United States. It was properly decided by the Court below. The decision of the Court of Appeals should finally terminate this action now pending in the Federal Courts for more than ten years.

Respectfully submitted,

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